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Politics this week

Jan 8th 2004
From The Economist print edition

A nicer neighbourhood

AP

The prime minister of **India** met the president of **Pakistan** for the first time in more than two years. They agreed to start talks on Kashmir and other subjects next month, in a marked lessening of tension between the nuclear-armed neighbours. The two countries also agreed with other South Asian nations to establish a free-trade zone by 2006.

See article: India and Pakistan

China announced its first new case of the respiratory disease **SARS**. The victim quickly recovered, though not in time to avert a mass slaughter of civet cats, blamed by the authorities for spreading the disease. A second suspected case was then reported.

See article: The return of SARS

Kofi Annan, the UN secretary-general, said that **Afghanistan's** fragile peace process was at a critical juncture because of security problems in the country. But a new constitution for Afghanistan was finally adopted after weeks of debate.

See article: Afghanistan's constitution

Staying sanctioned

The American administration said it would not lift economic sanctions against **Libya** yet, though it recently praised Muammar Qaddafi after he admitted that his government had secretly been trying to make weapons of mass destruction and promised to stop doing so. In response, the Libyans said they might delay paying compensation to victims of the Pan Am flight which was blown up over Lockerbie in 1988 by Libyan agents, killing 270 people.

See article: Suspicions about Pakistan's nuclear dealings

The American-led government in **Iraq** said it would set free 506 Iraqis, about 100 of them immediately. Most have been in captivity since the end of the conventional war in May last year.

See article: The Sunni Arabs of Iraq

Hosni Mubarak, **Egypt's** president, tried to squash speculation by explicitly denying that he wants his son, Gamal, to succeed him.

An Egyptian charter flight **crashed into the Red Sea**, killing all 148 on board, mostly French tourists. Foul play was not suspected.

Syria's president, Bashar Assad, said that he wanted to co-operate with the United States and reopen dicussions with Israel, but he refused to condemn Palestinian suicide bombers.

See article: Syria's diplomatic isolation

By agreeing on a formula for sharing the country's oil wealth, **Sudan's** government and its main rebel opposition, the Sudan People's Liberation Army, took a big step towards a formal peace pact and the establishment of a government of national unity. But a separate civil war continues in the region of Darfur, in the west.

See article: Sudan's two wars

Shops stopped accepting cheques from six of **Zimbabwe's** commercial banks, fuelling fears that hyperinflation and political interference have pushed the country's financial system close to collapse.

Rebels in **Côte d'Ivoire** rejoined the country's power-sharing cabinet, which they had stomped out of last year, accusing the government of violating the terms of a ceasefire pact.

Border patrol

President George Bush announced plans to reform America's **immigration laws**. These include giving legal status to up to 12m undocumented workers, around half of whom are Mexican. Meanwhile, a new visa-entry system was introduced at airports and seaports, using biometric technology to “fingerprint” most foreign visitors.

See article: A new immigration policy

A federal panel of judges upheld Texas's controversial **congressional-redistricting** plan, said to favour Republicans unduly. Meanwhile, Ralph Hall, a Democratic congressman for 23 years, switched sides and joined the Republicans.

See article: The Texas redistricting case

Howard Dean, the Democrats' presidential front-runner, lost much of his lead to Wesley Clark. One poll showed him just four points ahead, down from a peak of 21 points. But Mr Dean was endorsed by Bill Bradley, a former New Jersey senator who unsuccessfully challenged Al Gore in the Democratic primaries in 2000.

A memorial was chosen for the **World Trade Centre**. The “Reflecting Absence” will place two pools on the site of the twin towers surrounded by a wall and bear the names of the 2,752 people who died there on September 11th.

EPA

Rule of law

As expected, Mikhail Saakashvili won **Georgia's** presidential election by a landslide. Mr Saakashvili, a young American-educated lawyer, had led the wave of protests that forced his predecessor, Edward Shevardnadze, to resign last November.

See article: Georgia's new president

European Commission lawyers advised that European finance ministers had broken the law last November when they suspended proceedings under the **stability and growth pact** against France and Germany for running excessive budget deficits. The commission will now consider whether to haul member governments before the European Court of Justice, though it has recently lost several high-profile cases there.

Greece's prime minister, Costas Simitis, confirmed that he would resign as leader of the Socialist Party ahead of elections in early March. His hope is that his probable successor, George Papandreou, who is now foreign minister, may snatch victory in the elections. The Socialists trail the opposition New Democrats in opinion polls.

Mijailo Mijailovic confessed to the killing of **Anna Lindh**, Sweden's foreign minister, last September. This should spare Swedes the pain of never being sure who did the deed. Seventeen years on, no one has

been convicted of the killing of Olof Palme, Sweden's then prime minister.

Much at stake

In a blow to **Canada's** beef industry and a fillip to America's, officials from both countries said they believed that the first cow to be found in America infected with “mad-cow disease” came from Alberta, Canada.

Demonstrators demanding the resignation of President Bertrand Aristide of **Haiti** clashed violently with his supporters in Port-au-Prince, during a week of protests.

AP

The most senior leader of the Revolutionary Armed Forces of Colombia (FARC) to be captured since the group's insurgency began was handed over to **Colombia** after his arrest in Ecuador.

See article: Colombia's security policy

A team of scientists predicted that **global warming** could push between 15% and 37% of species towards extinction by the middle of the century.

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Business this week

Jan 8th 2004
From The Economist print edition

Beyond a bail-out

China's government began a long-awaited bail-out of the country's big state-owned banks. It gave **Bank of China** and **China Construction Bank** some $45 billion from its foreign-exchange reserves to shore up balance sheets strained by a vast pool of bad loans. China hopes to float the banks on the stockmarket in a year or so.

See article: China's bank bail-out

Meanwhile, in a further effort to bring a measure of integrity to the country's financial sector, China's stockmarket regulator took control of **China Southern Securities**, the country's fifth-largest brokerage. The heavily indebted firm was accused of “illegal and irregular operations, and disorderly management”.

Air safety

Airline passengers braced themselves for further inconvenience as security alerts led to the cancellation and delay of more flights to America. Several Air France and British Airways services and a flight from Mexico were affected; America told foreign airlines to put armed guards on some flights that it judged to be at risk or face a denial of landing rights.

See article: More security, more delays

Two big American engineering firms were awarded a $1.8 billion contract to rebuild Iraq's infrastructure. Critics of the allocation of reconstruction work in Iraq noted that both **Bechtel** and **Parsons** are big contributors to the coffers of the Republican Party.

Fax off

America's Federal Communications Commission pleased fax-owners across the country by levying the largest-ever fine against a spammer. **Fax.com** must pay $5.4m for 489 violations of a recent law that bans the faxing of unsolicited adverts. Many of the offers were for printer cartridges for overworked fax machines.

Walt Disney took steps to improve corporate governance. To allay fears that Michael Eisner, Disney's chief executive, is too powerful, two more independent board members were appointed with a third to follow. Another was deemed non-independent because of his wife's business dealings with Disney.

GlaxoSmithKline said that it would contest an American tax bill for $5.2 billion. The Internal Revenue Service claims that Glaxo Wellcome owes $2.7 billion plus interest in taxes between 1989 and 1996, before the company's merger with SmithKline Beecham.

Milked for information

Italian investigators continued to question six **Parmalat** executives held in prison without charge—including Calisto Tanzi, the firm's founder and former chairman—in an attempt to unravel the financial chicanery responsible for the huge hole in the company's accounts. Meanwhile, an American law firm filed

a class-action lawsuit for compensation of $1 billion against the Italian dairy-products firm, Citigroup and two auditors.

See article: The Parmalat investigations

Lord Black's chairmanship of **Hollinger International** was reportedly in the balance. Relations with the board are said to have deteriorated over his failure to hand back part of a $7.2m payment he received without board approval. Also, he provoked disquiet with his decision not to testify before America's Securities and Exchange Commission, which is investigating disputed payments of $32m to senior executives at the media group.

See article: Hollinger International

Martha Stewart's trial began in New York with the tough job of selecting an impartial jury. The life-style guru is charged with obstruction of justice, making false statements and fraud connected with the sale of shares in ImClone. Ms Stewart, who denies insider dealing, faces up to ten years in jail.

Pretty boy

Estée Lauder, an American cosmetics firm, announced that William Lauder, the grandson of the company's founder, Estée Lauder, would become chief executive, succeeding Fred Langhammer.

Chip sales are booming according to the Semiconductor Industry Association. Sales increased by 25% in November compared with a year ago prompting speculation that a long slump in technology spending is at an end.

See article: Another looming trade dispute?

Apax Partners and Hicks, Muse, Tate & Furst sold their remaining 34% stake in **Yell**, a British telephone-directory group, for £720m ($1.3 billion). The private-equity firms bought Yell from British Telecom for £2.1 billion in 2001.

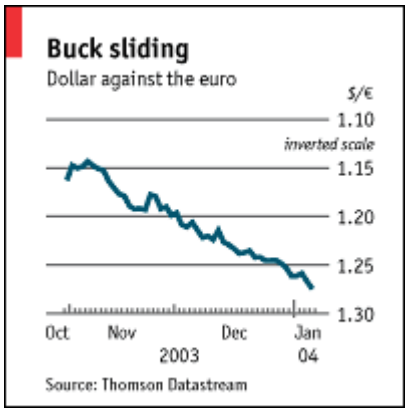
The price of debt

The International Monetary Fund warned that ballooning **American-government debt** threatens to drive up interest rates around the world.

See article: George Bush's big-government conservatism

The **dollar** continued to slide, hitting a new low against the euro. The price of gold also rose to a 13-year high as the greenback fell. Despite signs that the euro area's recovery may falter and the likely effect on exports of a strong euro, the European Central Bank left interest rates unchanged.

See article: Alan Greenspan and the American bubble



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Al-Qaeda

Still out there

Jan 8th 2004
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Some victories have been won in the West's war against al-Qaeda. But the danger persists

Get article background

LIKE a pantomime villain, the man who is once again the world's most wanted fugitive has re-appeared on the global stage just when it looked as if the plot might be taking a turn for the better. Another taped rant against Crusaders, Zionists and apostate Muslim rulers, purportedly delivered by Osama bin Laden, reminded America and its allies that the enemy who preoccupied them before the war in Iraq remains bent on their downfall. The cancellation and delay of flights to the United States from France, Britain and Mexico has also helped to deflate the festive optimism brought on by Saddam Hussein's capture. Ditto this week's introduction of what in bygone times would have seemed draconian security measures at American airports, rows about whether planes should carry armed guards, and worries about “dirty” bombs. And from Iraq to Israel, Istanbul to Islamabad, growing numbers of people are blowing themselves up for fanatical ends (see article).

In fact, the ongoing disruption to international air travel contains good news as well as bad. It suggests that western intelligence services have a handle on the plots the terrorists are hatching. At the same time, the inconvenience caused to passengers, and the disagreement among governments that have resulted, point up the havoc that terrorists can cause, even if those plots are scotched or spectral. In a similar sort of way, the war against al-Qaeda as a whole offers both good and bad news, progress and peril. It is likely to stay that way: this is not a war that can be ended by toppling a statue.

The view from the White House, and from the caves

With the pride that can go before a fall, George Bush's administration regularly and confidently asserts that it is winning the “war on terror”—and not without some justification. The invasion of Afghanistan denied al-Qaeda its sanctuary. More than two-thirds of its known senior leadership, say the Americans, have been captured or killed. Globally, more than 3,000 al-Qaeda operatives have been (as the Americans put it) “incapacitated”. Terrorist cells have been disrupted across Europe, and some previously recalcitrant countries seem finally to be co-operating in the hunt. In the case of Saudi Arabia, that is partly because, by targeting Muslim Saudis, Mr bin Laden's cadre has made what may turn out to be a strategic misjudgment. All of this has made it more difficult for al-Qaeda to move its men and cash around.

In America itself, chastened spies have pulled their socks up. Ports and borders are better protected than they were, and the emergency services better prepared to respond should the bomber (or germ-warrior) get through. So far, these precautions seem to be paying off. Since September 11th, al-Qaeda and its affiliates have struck repeatedly at “soft” (ie, civilian) targets in Turkey, Morocco, Kenya and elsewhere. But there have been no attacks on the catastrophic scale of the World Trade Centre, and none in mainland America or in America's key western allies. The erosion of a few civil liberties and a few cross airline passengers, Mr Bush might argue, are small prices to pay for this relative tranquillity.

But now imagine that you are Mr bin Laden. You may feel that you have just as many reasons to be cheerful. You have struck the hyperpower in its heartland. You have sown fear and discord in the West. True, you were put to flight in Afghanistan, but your friends are far from beaten even there. In Iraq,

America has deposed an apostate, with a number of satisfying results. The infidels are leaving Saudi Arabia, answering your chief political grievance, a much more important one to you than the plight of the Palestinians—a cause, however, that you continue to exploit. America's popularity in the Muslim world has plummeted. Things may change if Iraq emerges as a model Arab democracy, but for now, in some Muslim countries, more people say they have faith in your conduct of world affairs than in Mr Bush's. Your associates can still raise and distribute more than enough money to fund their inexpensive operations. And neither you nor your most important aide, Ayman al-Zawahiri, has been killed or apprehended. You may be incapacitated and sometimes incommunicado, but you remain a powerful totem of *jihadi* resistance.

Perhaps skulking in a cave on the Afghan-Pakistani border, Mr bin Laden might also reflect that al-Qaeda enjoys two strategic advantages over its enemies. One is its diffuseness. Even before the loss of its Afghan base, al-Qaeda was not an organisation in a conventional sense: Mr bin Laden operated more like a venture capitalist than a CEO, sponsoring operations with varying degrees of control. Since then, the alumni of his Afghan camps—perhaps numbering in the tens of thousands—have dispersed across the globe, forming their own more or less autonomous units. Some of the bombings committed under the al-Qaeda banner may take little more than inspiration from Mr bin Laden himself. Nobody really knows how large that loose network is, nor whether it is growing or shrinking.

A different kind of war

Al-Qaeda's other strategic advantage is its philosophy of time. As the typically obscure references in the latest tape illustrate, Mr bin Laden and his sort take a long view of history, lamenting the reconquest of Andalucia in 1492 as well as more recent “offences”. They are impatient for the advent of the global caliphate; but they can also wait. They plan meticulously and nurture their aspirations—such as the destruction of the World Trade Centre, and the use of planes as weapons—for years. Given that, the world should draw little comfort from the fact that it has so far been spared another September 11th.

Since al-Qaeda is less a concrete adversary than a movement or an ideology, any war waged against it must be equally subtle. “Incapacitation” has its place, but so do public diplomacy in the Muslim world and conflict resolution in the Middle East and beyond—both less in evidence. A “war on terror” in general makes even less sense. It suits Russia's Vladimir Putin and Israel's Ariel Sharon, for example, to portray their battles with Chechen and Palestinian terrorists as part of a global struggle; but these and many other campaigns involve mainly local issues. Most terrorists, moreover, still operate within self-imposed constraints, whereas Mr bin Laden regards the acquisition of weapons of mass destruction as a religious duty. Lumping these threats together under the general rubric of a “war on terror” makes them harder to address.

Another part of the anti-al-Qaeda strategy ought to be the education of western publics. Talk of a “war” itself encourages people to believe in a clear and not-too-distant victory, whereas the apocalyptic spirit of al-Qaeda may be around for decades. “Terror”—which is, after all, a technique rather than an army—will stalk the world forever. It is tricky for anyone not privy to the intelligence that informed the grounding of flights this week to assess whether it justified the alarm and inconvenience that were caused. But the public would be able to cope better with such trials if it understood that the al-Qaeda peril is one with which it will have to learn to live for the foreseeable future—and which, unfortunately, will occasionally inflict more than just inconvenience. Some phlegmatic European officials whisper that their American counterparts have become overly risk-averse, believing that they can see off every threat that may arise. That is unlikely to be possible.

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India and Pakistan

Hope, at last

Jan 8th 2004
From The Economist print edition

The news from Islamabad is hugely heartening. But the gains are hugely vulnerable

"HISTORY has been made," claimed Pervez Musharraf, Pakistan's president, on January 6th, though "remade" would have been nearer the truth. At the summit meeting of a group of South Asian nations in Islamabad this week (see article), General Musharraf and India's prime minister, Atal Behari Vajpayee, clasped hands and put two dreadful years of sabre-rattling and terror behind them. The nuclear neighbours have now arrived, more or less, back where they were in 2001, before the failed Agra summit in July of that year and the attack on India's parliament building in Delhi that December drove them to the brink of Armageddon. The task now is to move beyond that point, and towards lasting peace.

It has been a difficult, gradual process, and one for which many actors deserve credit. Mr Vajpayee started things moving, in April last year, with a speech in which he held out "the hand of friendship" to Pakistan. That was pretty easy for him. Since India holds the best half of Kashmir, which lies at the heart of the two countries' differences, it can negotiate from a position of strength. Even so, it took a degree of political courage in the run-up to India's state and general elections. Pakistan-bashing, not handshakes, is what usually wins votes in India. General Musharraf deserves praise too, for eventually taking up that offer. Last week's announcement that he may no longer be insisting on a referendum in Kashmir, though arguably only a recognition of reality, helped a lot as well.

The Americans also deserve congratulation. Fearful of seeing a vital front in their war in terror disintegrate—as it would should India and Pakistan once again come to blows—they have twisted arms, the general's in particular, with vigour. For all that he is a key American ally, General Musharraf is also a big worry: an unstable, nuclear-armed (and proliferation-prone, see article) Pakistan is a threat to the entire region, and potentially to America itself. But after the Americans talked tough last autumn, the general stepped up the pressure on extremist groups and sent his army into remote tribal areas to help with the work of flushing out the remnants of the Taliban and al-Qaeda there. In the past few weeks, he has finally persuaded the Indians that he is worth talking to again.

So now diplomatic links between Pakistan and India are fully restored, as are air links, with rail ones to return shortly and a bus service across the "line of control" in Kashmir in the offing. The Islamabad summiteers agreed that senior officials will start meeting in February, to discuss all areas of disagreement, Kashmir included. This is still far from the detailed framework for negotiation that the Agra summit was meant to establish, but it is a big step towards it. All the same, the main question remains just what it always has been: can goodwill and talks be turned into a durable peace?

Always Kashmir

It certainly won't be easy. Pakistan and India have been arguing over Kashmir for close to half a century. Two of the three wars the neighbours have fought have been over this scrap of territory. India now holds about half of what was once a princely state, where a Hindu maharajah held sway over his mainly Muslim subjects, and Pakistan most of the rest, though China has nabbed a little too. Kashmir (India's part of it) is not just extraordinarily beautiful, but of strategic importance. India fears that a Pakistani Kashmir, or an independent one that looked towards its fellow Muslim country, would be an impregnable redoubt menacing its rich northern states. More generally, India fears the principle of self-determination. If it

were granted to Kashmir, it might reasonably be demanded right across India's multi-ethnic patchwork.

For Pakistan, though, the stakes are hardly any smaller. The quest to liberate the fellow Muslims of Kashmir started with independence in 1947. So many lives have been shed in pursuit of this aim that surrender would be deeply painful. India would be delighted to turn the existing division, which gives it the heart of the state, into a permanent border. But for Pakistan, this would be a humiliating defeat. The very name Pakistan, a modern invention, includes a “K” for Kashmir.

Might it not be possible for talks on the issue to drag ponderously on while other aspects of the relationship between these two powerful countries become a little more normal? At present there is virtually no trade across the long India-Pakistan border—though the hope, expressed at the Islamabad meeting, is that this could now start to change, with a South Asian free-trade zone planned for as early as 2006.

In some parts of the world, it has seemed possible to spin a peace process out forever without encountering a bloody breakdown. Cyprus certainly qualifies, with no hostilities to speak of for a quarter-century—but no resolution either. Northern Ireland looks as though it is sliding into the same category. But talks that drag on for years and years also carry their risks. Palestine provides one counter-example: on both sides are zealots who make compromise all but impossible, and who are prepared to resort to violence to pre-empt any risk of it. Sadly, there is reason to think that Kashmir may fall into this category. The lesson of the past two years or so is that relations between India and Pakistan are extraordinarily sensitive to the actions of violent men.

There are two great dangers. One is that Islamic terrorists, nurtured by Pakistan's intelligence service for the long proxy war with India in Kashmir, will refuse to accept that they have outlived their usefulness. It would take only one large bomb directed against a civilian target in the Indian heartland for all the good work of Mr Vajpayee and General Musharraf to be undone. The other danger is even more chilling. By abandoning the Taliban and siding with America in Afghanistan, by taking on militancy at home, and now by moderating his demands on Kashmir, the general has become the prime target of the terrorist groups that infect his country. Two bomb attempts in December revealed a degree of inside knowledge of the general's movements, and only narrowly missed. Stanley Baldwin warned in the 1930s that “the bomber will always get through”. Should that happen in Pakistan, the dream of peace with India could well be among the casualties.

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Monetary policy

The trouble with bubbles

Jan 8th 2004
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Alan Greenspan's victory lap is premature

Reuters

IN 1998 and 1999 *The Economist* argued that the Federal Reserve should tighten monetary policy to let some air out of America's economic and financial bubble. At the time, most commentators denied that a bubble even existed. Most now agree that it was probably the biggest bubble in history. Despite this, Alan Greenspan, the Fed's chairman, this week declared himself vindicated in his decision not to prick the bubble with higher interest rates, and to wait instead for it to burst and then cut rates sharply to cushion the consequences.

The economy has certainly fared much better than we expected since the bubble burst. America's recession in 2001 was its mildest in history. Although the initial recovery was feeble, the economy has grown by a robust 3.5% over the past year. This is largely because the effects of lower share prices have been offset by a massive monetary and fiscal stimulus, and a slide in the dollar. Mr Greenspan deserves credit for recognising the potential dangers when the bubble burst. He wisely avoided the Bank of Japan's mistake in the early 1990s of not cutting interest rates fast or far enough.

But the mildness of America's downturn and its recent rebound does not prove that the Fed was right to turn a blind eye to the bubble in the first place. The key question is whether America's economy would now be on a firmer foundation if the Fed had acted against the bubble. And much more is at stake than whether Mr Greenspan is a hero or a klutz. How central banks should respond to surges in the prices of assets, such as shares and houses, over and above their impact on inflation, has become a hot issue for central bankers everywhere. Some outside America—including officials at the Bank of England, the Reserve Bank of Australia and the Bank for International Settlements (the central bankers' bank)—have expressed sympathy with the view that monetary policy should sometimes respond to big surges in asset prices.

Mr Greenspan fields two arguments against trying to curb share prices with higher interest rates. First, that one cannot be sure when or if a bubble is forming. Second, that a rise in rates sufficient to prick a bubble could also trigger a deep recession. It is therefore safer, he says, to wait for a bubble to burst and then cushion the economy by slashing rates. The mildness of the last recession might appear to support his reasoning.

It is wrong, however, to focus only on the stockmarket bubble. The longer a bubble is left to inflate, the more it encourages the build-up of other imbalances, such as excessive debt. When these imbalances unwind, there is a risk of a long period of sluggish growth. Mr Greenspan's fans claim that America has escaped a prolonged downturn. That may prove to be so but it is too early to be sure, simply because the imbalances created by the bubble, such as low saving and record borrowing, have yet to be unwound. Instead, the economy has been kept going by a further bout of consumer borrowing and by massive government borrowing, pushing the total budget deficit to 5% of GDP. Such indebtedness is unsustainable. At some stage households must save more and spend less, as must the government. At the very least, America's debt overhang leaves its economy more vulnerable to its next downturn.

Moral hazard

A second reason to pause before declaring victory is the worrying asymmetry inherent in the Fed's policy.

Lowering interest rates when asset prices tumble but not raising them when they soar could make speculative bubbles more likely in future as firms and households are encouraged to take ever-bigger risks. The Fed has arguably offset the bursting of one bubble by inflating another in the housing markets of many American cities. That has allowed consumers to go on partying, but what happens when the Fed eventually has to lift interest rates?

It is impossible to say with certainty what would have happened if American interest rates had been higher in the late 1990s. Yet it is also impossible to declare the Fed's policy an unequivocal success until saving and borrowing have returned to more sustainable levels. Encouraging households to borrow more and more hardly builds a firm foundation for future growth. We concede that running monetary policy is a lot trickier than writing editorials criticising central banks. And given the difficult circumstances during America's boom and bust, Mr Greenspan surely did a better job than some central bankers might have done, especially his Japanese counterparts. But it would be a pity if his eagerness to answer his critics led other central banks to draw the wrong lessons.

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Princess Diana's death

Are you there, Elvis?

Jan 8th 2004
From The Economist print edition

A police investigation into Princess Diana's death is not enough

AP

Get article background

THIS week's news that the coroner on the inquest into the death of Princess Diana has called for a police investigation into the crash that killed her in 1997 was greeted with justified jubilation by much of Britain's tabloid press. “Diana death plot sensation” screamed one of the hoardings, in the ultimate distillation of journalistic bliss. There were, unfortunately, one or two carpers who complained that this will be a waste of time and money. They are evidently financed by Prince Charles through secret Swiss bank accounts and protected by North Korean mercenaries trained to kill on sight.

So what if the Metropolitan Police has other things on its mind, what with the terrorist threat and all that? Who cares that the French police spent two years combing the ground around the princess's death and came up with pretty much nothing in 6,000 pages of evidence which the unfortunate top copper assigned to the Diana job will now have to plough his way through?

The princess, according to a letter she wrote which the *Daily Mirror* published this week, believed Prince Charles was planning to murder her. Never mind that she was clearly a woman on the verge of a nervous breakdown and that most divorcees suspect their ex-spouses of wanting to vaporise them. The suspicions of the People's Princess should be good enough for the rest of us. What's more, as the coroner said, “there is speculation that these deaths were not the result of a sad, but relatively straightforward, road traffic accident in Paris”. There is, indeed, much speculation—around 10,000 websites dedicated to the subject, and a belief widely held in the Islamic world that the royal family had Diana wiped out because she wanted to marry a Muslim.

Volume of speculation is an excellent basis for directing police investigations. The world is awash with conspiracy theories far more entertaining than the dreary realities of everyday crime. Diana's death is only one of a number of fruitful areas on which the expertise of the Metropolitan Police could in future be trained. Everybody, for instance, knows that there is a Nazi base on the South Pole where Hitler is finalising his plans for the Third World War. John Lennon, it is common knowledge, was taken out by British intelligence. And where, after all, is Elvis? At last we shall be told.

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British Conservatives and university fees

Top marks for cynicism

Jan 8th 2004
From The Economist print edition

The Tories' opposition to reforming higher education will damage universities and themselves

Get article background

MICHAEL HOWARD'S assumption of the Conservative Party's leadership in November has given the Tories new vim (see article) but they still have much to do. One of the things they need to change is the image of both party and leader. The Tories are seen as nasty, unprincipled losers. Mr Howard is just seen as nasty and unprincipled. That is why the party took out a double-page advertisement in the *Times* on January 2nd expounding its new leader's core values.

This uneven document combines the obvious ("I believe it is natural for men and women to want health, wealth and happiness for their families and themselves") and the baffling ("I do not believe that one person's sickness is made worse by another's health") with one clear statement of belief ("I believe that the people should be big. That the state should be small"). Assuming that Mr Howard isn't taking sides in the obesity debate, this avowal gestures towards a belief that divides the Conservative Party from most of the Labour Party (though not Tony Blair) and should set a framework for Tory policies. It is unfortunate, then, that the Tories' stand on what is currently Britain's biggest domestic political issue—reforming universities—flatly contradicts this principle.

British higher education has suffered from two decades of underfunding, as successive governments have expanded student numbers without either giving the universities enough taxpayers' money to pay for the growth, or allowing them to raise enough private cash to do their job properly. Margaret Thatcher and John Major ignored the problem. Tony Blair has decided to do something about it. His solution is to charge students more for their university education through loans which they will pay back if they get sufficiently well-paid jobs afterwards. This is how Australia's healthy higher education is financed, and is pretty similar to the way America mainly pays for its rich, flourishing tertiary sector. Europe's crumbling universities depend on the state.

Class acts needed

It is understandable that many Labour MPs should oppose the plan. They know that allowing universities to charge, and set, fees will reduce state control and encourage institutions to differentiate themselves, developing courses of varying length, depth and quality. They fear that will mean a "two-tier" system (one for the rich, one for the poor); they prefer state-imposed egalitarianism to the efficiency, variety and choice that such a system would offer.

Tory opposition to such a change is harder to square with the party's supposed values. Giving people responsibility for investing in themselves instead of leaving it to the state fits comfortably with another verse of Mr Howard's credo: "I believe people are most likely to be happy when they are masters of their own lives, when they are not nannied or over-governed". And more financial independence for universities means less state control. Big people, small state. Still, the reasons for the disjuncture between principle and policy are not hard to fathom. The Tories think that if they side with Labour rebels, Mr Blair will be in big trouble. Hurrah.

But the main effect of the Tories' position will be to reduce the chances that Britain will be able to rebuild

a decent university system. The government's plans have already been watered down in several ways to win over Labour rebels. For instance, an “access regulator” is supposed to ensure that universities take plenty of students from poor backgrounds and there is to be a cap on the annual fees which universities can charge. Universities will not be allowed to levy even half of the annual cost of a course at a top university, so their fee income and thus their independence will be limited.

How much will the Tories benefit from their opportunism? Not a lot, probably; it could even do them some harm. Although Mr Blair's plans for universities have been attacked from both right and left, they are not obviously unpopular: some polls show a majority against them, some a majority in favour. Mr Blair will probably be able to strong-arm enough MPs for his bill to scrape through. Meanwhile the Tories' blatant cynicism may well undermine their drive to be taken seriously as a party of passionately-held beliefs. So it should.

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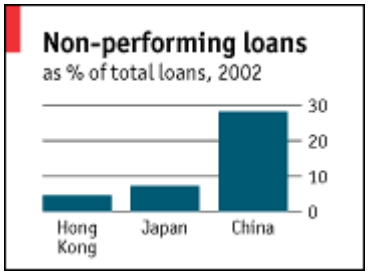
China's banks

Beyond a bail-out

Jan 8th 2004
From The Economist print edition

Painful changes, not just fresh cash, are needed to clean up China's banking mess



DRAGONS, as any child can tell you, have a weak spot: their underbelly. In China's case the underbelly is its financial system. Unable to price loans and allocate capital properly, the country's banks have buried themselves under an avalanche of bad loans. Eventually, this could threaten a collapse of China's entire financial system. But even if the country manages to avoid that particular disaster, which it probably will, the continued use of its banks as cash machines for its unprofitable state-owned enterprises is a big drag on China's rapid economic growth, and may well end up imperilling it.

Policymakers in Beijing understand and fear this. Hence the launch this week of yet another attempt to bail out the banks (see article). This latest scheme undoubtedly looks neat. By pumping $45 billion of its massive $400 billion of accumulated foreign-exchange reserves into the banks, China seems to be making effective use of a ready pool of funds, currently parked in relatively low-yielding assets. Yet repeated capital injections, even clever ones, are not themselves a genuine solution to China's banking problems. Since 1998, China has spent roughly $200 billion in recapitalising its banks and writing off bad loans, to little avail. Politically directed lending to favoured industries has continued as before, and the old, written-off bad loans were soon replaced by new ones. Today, some independent estimates put the level of bad loans at around $420 billion, or nearly 40% of gross domestic product.

To clear up the mess that already exists will certainly take money—and lots of it. This week's injection should be the first step in a larger scheme. But fresh funds must go hand in hand with other things. An accelerated move to strengthen the legal system is one of the most urgent. China desperately needs a formal bankruptcy law. It is ludicrous that, under the current law, largely rotten state-owned companies can survive while a separate law for foreign-owned firms gives creditors far better protection. A bankruptcy bill covering all categories of companies has been in draft form for years, held up by fears that it would be used to throw lots of state-owned workers out of their jobs. That is a risk, and any such changes will be painful (see article), but China needs to grapple with these changes sooner rather than later.

To avoid creating fresh bad loans—especially at a time when lending is growing at 20% or more each year and some sectors are overheating—China's central bank and banking regulator must also insist on far-reaching governance and cultural reforms at the banks. At banks' headquarters, there are many smart, western-educated managers, armed with modern risk-management systems. But their fiat does not reach down to the branches, where ties of loyalty (and corruption) bind local managers to local officials and businessmen. Even at the centre, the banks need to introduce truly independent boards and auditors as well as proper pay scales and incentives. Credit-approval processes need to be clearly separated from loan-making and centralised payment-systems must be installed. Some of this is being done, but not quickly enough.

Open the doors

The best way to promote such reform would be to encourage direct investment by foreign banks in China's own banks, and to allow them to compete on equal terms with institutions that prefer to remain wholly domestic. China's bankers could learn an enormous amount from foreigners, both as partners and rivals. And yet instead of welcoming foreign involvement in banking, China is dragging its feet and is likely to continue to do so even after 2007, when it has pledged, under World Trade Organisation rules, to open its financial sector fully to foreign competition and investment.

None of this is easy. Other transition economies, from Eastern Europe to Latin America, have spent years struggling to clean up banking industries hobbled by a legacy of political interference. Even developed Japan is still clawing itself out from under a mountain of bad loans. Any solution to China's banking dilemmas will also take time. But that makes it more, not less, urgent that China begin to make the necessary changes. The longer the problem is left to fester, the worse it will become. And with China now, by any measure, one of the world's biggest economies, it matters to everybody, not just the Chinese, that China does not fail at this difficult task.

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Letters

Jan 8th 2004
From The Economist print edition

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Don't blame Wolfowitz

SIR – Your criticism of Paul Wolfowitz is false and unfair ("You're not all right, Jacques", December 13th). Recently the administration decided to allow American taxpayer dollars to fund prime contractors only from the United States, Iraq, other coalition partners and nations contributing forces to the effort in Iraq. This was the right decision, it was a principled decision and it was a decision that was approved by the president in concert with every member of his national-security team.

To lay any criticism of this decision at Mr Wolfowitz's doorstep is unfair. The deputy defence secretary is an important member of the national-security team. The president values his counsel, judgment and principled leadership. He serves the American people with honour and integrity.

Steve Hadley
Assistant to the president and deputy national security adviser
Washington, DC

SIR – The Bush administration should be showing the American people and the world that it is doing everything possible to increase the efficiency and decrease the cost of reconstructing Iraq. Eliminating competition and barring countries with experience in Iraq, such as France and Russia, does not help. More important, an opportunity to gain diplomatic advantage has gone. The administration often complains of a lack of international support in the reconstruction process. If France, Germany, Russia and Canada have companies and citizens working in Iraq they would surely have an incentive to lend more financial and military resources?

Sean Fox
San Rafael, California

A funny lot

SIR – You ask whether the French have a sense of humour ("Very droll", December 20th). Their elevation of Jerry Lewis to the Legion of Honour demonstrates that they are capable of self-parody. Also, let us not forget that Jacques Tati was justly known as the French Charlie Chaplin. It is the Germans we should be concerned about. A more humourless folk are scarcely imaginable. A caricature of Gerhard Schröder singing "The Tax Song" was televised last year. Germans were not amused. It provoked serious debate in the press and parliament about whether such things should be allowed.

Hans Anders
Chur, Switzerland

SIR – The French may lack a sense of humour; in Italy our prime minister no longer allows satire. Silvio Berlusconi stopped a recent programme because it was too nasty about the government. Daniele Luttazzi, my favourite Italian humorist, had a popular programme cancelled on RAI (the state-owned television channel) because he attacked Mr Berlusconi too heavily. Mr Berlusconi is not only scared of judges; now he also fears comedians.

Luca Fracassi
Amstelveen, The Netherlands

SIR –*The Economist* writes about French humour and the vivacity of Latin once or twice a generation. To enlighten the next articles on either, you may wish to acquire “Asterix the Gaul” in Latin. I bought a copy 30 years ago in Brussels airport. It is even funnier than the French original.

David Heigham
Madrid

Part of the equation

SIR – To regard Latin as the original world language or the preferred language of philosophy and science is to adopt a Eurocentric world view that has long been discarded (“Roman rebound”, December 20th). The classical languages of civilisation include Arabic, Chinese, Greek and Sanskrit. All are praiseworthy for a clarity and precision that helped to pave the way for the artificial language of algebra.

Algebra reached Europe via the Arabs. Euler, Bernoulli and others used it to translate Newton's laws from Latin into equations that were more universal. Therefore, to say that Latin was for Newton “the closest approach in words to the utter directness of mathematical symbols” is putting history on its head.

Frits Staal
Berkeley, California

Dangerous dynasty

SIR – You say that in Bangladesh two combative widows seem to take it in turns to run their country (“Born to rule”, December 20th). You are half right; the current prime minister, Khaleda Zia, is indeed a widow. She was married to President Zia Rahman who was assassinated by disaffected army officers in 1981. Sheikh Hasina Wajed, the opposition leader, is married to Wazed Ali Miah, a nuclear physicist. Army officers murdered her father, Sheikh Mujibur Rahman, the founder of Bangladesh, along with most of his family in 1975, effectively ending democracy in Bangladesh until 1991. Fortunately, Sheikh Hasina was in Germany at the time.

Miran Ali
Dhaka, Bangladesh

SIR – You downgrade Bill Clinton in your presidential league table for “Brilliance outweighed by dishonesty”. Will your newspaper's disproportionate emphasis on his minor sexual affair and unsurprising denial never end? Your prudish shock would be heartily endorsed by your top-ranked monarch—Queen Victoria.

Anthony Lunn
Princeton, New Jersey

Wait a cotton pickin' minute

SIR – As a proud South Carolinian, I must tell you that you have incorrectly identified the Sea Island states (“A great yarn”, December 20th). The Sea Islands are found in South Carolina, Georgia and north-east Florida; North Carolina has Outer Banks, not Sea Islands. As the order of monarchs suggests (Charles II before George I), both colonisation and cotton cultivation occurred in South Carolina before Georgia. I might also add that Eli Whitney's 1794 patent was in response to a contest sponsored by South Carolina's state government and that none other than the fictional Rhett Butler was a native South Carolinian.

Luther Carter
Folly Island, South Carolina

Staff newsletter

SIR – Barbara Smith's reminiscences are delightful, warm and fascinating (“Not so hard labour”, December 20th). Although she mentions the renowned and vastly entertaining Geoffrey Crowther, and Elizabeth Monroe, she overlooks another shining star of *The Economist*: Barbara Ward was bright, charming and packed an influential wallop. As American neophytes from the Office of Strategic Services learning from our Special Operations Executive and Political Warfare Executive elders in war-torn London

in 1941, we argued and partied with Crowther and Ward. Both commanded high respect from British and American leaders.

Fisher Howe
Washington, DC

SIR – Barbara Smith's anecdote about an exchange between Kim Philby and “a rather curious American oil man briefly recruited to *The Economist*'s staff” reminds me of a conversation long ago with the unnamed American. He said that his career change meant that *The Economist* was paying him less to write the stuff than the oil company had paid him to read it.

J.E. Peterson
Tucson, Arizona

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Suicide terrorism

Martyrdom and murder

Jan 8th 2004
From The Economist print edition

AP

Terrorists have embraced suicide attacks mainly for their advantages in this world, rather than their rewards in the next

“I HAVE always dreamed”, says an anarchist in Joseph Conrad's novel “The Secret Agent”, “of a band of men absolute in their resolve to discard all scruples...No pity for anything on earth, including themselves, and death enlisted for good and all in the service of humanity.” But, Conrad's anarchist complains, “I could never get as many as three such men together.” These days, there seems to be a superabundance of people willing to die in order to commit murder: in Turkey, Saudi Arabia, Chechnya and Russia, Pakistan, Israel, Iraq, Afghanistan and elsewhere. Is this phenomenon new? If so, what explains it? And what can be done about it?

Suicide terrorism, like the slippery concept of terrorism in general, is harder to define than it may appear. For instance, are the suicide bombings in Israel really so different from previous incidents in which Palestinian gunmen and knifemen (and the occasional Israeli) launched assaults that they had little hope of surviving? They were scarcely the first to sacrifice their own lives in order to take others. In the first century AD, the Zealots and Sicarii, two Jewish sects, attacked the Roman occupiers of Judaea and their allies in public places. The Assassins, a cult active in modern Iran and Syria from the 11th to the 13th centuries, killed their targets (mainly Muslim rulers whom they considered apostates) at close range and with no escape routes. Their name comes from the Arabic *hashishiyya*; the drug's powers were thought to explain the Assassins' oblivious bravery.

From the mid-18th century, other groups launched suicidal attacks against colonial rulers in India, Indonesia and the Philippines. Then there are the countless individuals who have died for a cause without taking others with them: think of Irish and Kurdish hunger-strikers, or of the human minesweepers despatched by Iran during its war with Iraq.

Yet for all these partial precedents, there is something novel about the type of terrorism in which the terrorist's death is a necessary and essential part of his act, not just an incidental cost. This type arrived in Lebanon in the early 1980s. Before then, modern groups such as the IRA and ETA, the Basque separatist movement, planned to escape after (or before) their bombings, mortar attacks and so on. Hizbullah's campaign of suicidal car and truck explosions—one of which killed 241 Americans in Beirut in October 1983; 58 people died in a strike on a French barracks on the same day—changed the face of terror.

The fact that Hizbullah started the trend, and that its spread has coincided with the rise of other Islamic groups—Hamas, Palestinian Islamic Jihad (PIJ), al-Qaeda and others—has led some to surmise that Islamic fundamentalism somehow explains it. Proponents of this theory can cite the lengths to which some terrorists go to justify their attacks in Islamic terms, manipulating the precedents set by the Prophet and his companions and finessing the meanings of three key concepts: suicide, martyrdom and *jihad*.

Unholy warriors

The Koran is unequivocal about suicide: as a mark of despair in Allah, it earns eternal damnation. On the other hand, martyrdom—death in *jihad*, incurred in Allah's name—earns eternal bliss: “Think not of those who are slain in Allah's way as dead. Nay, they live, finding their sustenance in the presence of the Lord.” The Koranic outline of the martyr's rewards in paradise is elaborated in the *hadith* (prophetic sayings and anecdotes) and has been embellished by generations of scholars. Islamic suicide bombers go to their deaths variously expecting to meet the Prophet and to see the face of Allah. Their sins will be forgiven, and they can intercede for their relatives on the day of resurrection. They will live amid rivers of wine and honey, and be married to 72 black-eyed virgins.

But should their bombings count as sinful suicide or glorious martyrdom? That partly depends on how the volatile concept of *jihad* is defined. For many Muslims, *jihad* is principally an internal struggle. But, especially since the advent of Wahhabism, a branch of Sunni Islam that evolved in the 18th century, the notion of *jihad* as external warfare has been revived. Despite Koranic injunctions to the contrary, some radical Islamic thinkers have justified the killing of civilians, and of other Muslims, in the name of *jihad*.

Likewise, suicide bombings—or “martyrdom operations”, as some of their exponents prefer—have been rationalised as a praiseworthy embrace of death at the hands of the enemy, and as a legitimate tactic *in extremis*. Among other sophistic arguments, some terrorists say that Allah, and not the bomber, decides whether the latter will die, and whether women and children will perish with the *shaheed* (martyr). Some scholars believe that a newly strident view of martyrdom, adopted by many Shia Muslims after the Iranian revolution of 1979, informed the new species of terrorism that Hizbullah, a Shia group, developed not long afterwards.

A firm belief in paradise is clearly an asset for anyone strapping on a bomb. But all these theological somersaults suggest that religion may be as much a hurdle, which the perpetrators of “martyrdom operations” need to overcome, as a motive for their violence. Hizbullah's clerics, for example, have always been squeamish about suicidal missions. And, quite apart from these qualms, there is another compelling reason to doubt that Islamic fundamentalism accounts for the rise of suicide bombing: non-Muslims are among its most devoted practitioners.

Human cruise missiles

The single most prolifically suicidal terrorist group is the LTTE, or Tamil Tigers. In the course of their attritional struggle for an independent Tamil state in northern Sri Lanka, the LTTE has, among scores of other attacks, bombed the World Trade Centre in Colombo in 1997 and assassinated two heads of state. LTTE suicide missions, which began in 1987, are inspired more by cultish devotion to Velupillai Prabhakaran, the group's leader, than by religion. The Kurdish PKK, which has deployed suicide bombers in its quests for Kurdish autonomy and for the release of its captured leader, Abdullah Ocalan, is influenced less by Islam than by Marxist-Leninism. So too is the Popular Front for the Liberation of Palestine, which perpetrated the first suicide strike in Israel for more than two months on Christmas Day.

Another sort of explanation for suicide terrorism focuses on its practitioners' travails and poverty in this world, rather than their imagined delights in the next. It used to be the case that a Palestinian bomber conformed to a recognisable type: he was young, male, single, religious and unemployed. He often had a personal grudge against Israel—for instance, a relative who had been arrested or injured by the Israeli army. He may have hoped to secure earthly as well as heavenly rewards for his relatives, in the form of financial donations after his death, and the new house that his parents might be given after the Israelis demolished their old one as punishment for his crime.

Reuters

The aftermath in Riyadh

But the affluence of many of the September 11th hijackers cast doubt on the notion that poverty was a necessary, let alone sufficient, condition for suicidal terrorism. And since the start of the second *intifada* in 2000, the profile of Palestinian bombers has changed: several have been well educated and less devout than those of the mid-1990s. The LTTE, and especially the PKK and Chechen terrorists, have preferred female bombers, because they attract, or used to attract, less suspicion. Some Palestinian groups (though not al-Qaeda) have also used women, conjuring up fresh religious sophistries to justify female martyrdom. Globally, says Yoram Schweitzer, an expert in suicide terrorism at the Jaffee Centre for Strategic Studies in Tel Aviv, the bomber has no clear profile.

A better way to understand the popularity of suicide attacks may be to focus on their advantages for the groups who commission them. Such operations are rarely, if ever, the work of lone lunatics. Hamas, PIJ and the other Palestinian groups who practise suicide terrorism recruit, indoctrinate and train their bombers. They write the texts for the video testaments filmed shortly before each self-immolation (making them unreliable records of the true motives of the “martyr”), which the bombers themselves watch to redouble their resolve. They take the photographs that will later appear on propaganda posters. Then they deliver their foot-soldiers to pre-identified targets. Al-Qaeda is remarkable for the expertise and independence of its agents, but they too are trained and primed for their missions.

Suicide bombing is a corporate effort: in this respect, the closest historical analogy may be the *kamikaze* pilots who trained as a cadre to terrorise the American fleet in the Pacific in 1944-45. And suicide appeals to these groups principally because it is a good way to kill large numbers of people. Robert Pape, of the University of Chicago, calculates that between 1980 and 2001 13 people died on average in every suicide attack, whereas just one was killed in other terrorist incidents—excluding September 11th, which would make the death ratio much starker. For those whose aim is maximum destruction, not just maximum publicity, it is the natural choice.

This special deadliness is partly the result of the suicide bomber's ability to adapt the place and time of his detonation to the last minute. As Bruce Hoffman of Rand, a think-tank, puts it, the suicide bomber is “the ultimate smart bomb, or human cruise missile”. If the bomber is spotted, he can detonate instantly. Fathi Shiqaqi, a founder of PIJ, used these unique advantages to justify “martyrdom operations”. The Palestinian groups regard suicide attacks as a way to counteract Israel's conventional military superiority.

Depending on death

Suicide is also a flexible technology. Where Hizbullah used cars and trucks to attack well defended installations, Hamas, PIJ and some Chechen bombers mingle among civilians, their concealed belts or vests loaded with explosives and shrapnel. The LTTE, which turned to suicide because other methods were having frustratingly little impact, has despatched suicide bombers in boats, and to conduct assassinations: much easier if the assassin has no intention of escaping. Whoever sent the two suicide bombers who narrowly failed to kill General Pervez Musharraf, Pakistan's president, also on Christmas Day, understood that advantage.

Counter-intuitive though it may seem, terrorists also regard suicide attacks as low-risk, given the scale of devastation they can inflict. As Ayman al-Zawahiri, Osama bin Laden's right-hand man, has put it, “the method of martyrdom operations [is] the most successful way of inflicting damage against the opponent and least costly to the *mujahideen* in terms of casualties.” No accomplices are needed for rescues or getaways. Nor is there much danger of bombers betraying their comrades: if LTTE emissaries survive the

explosion, they bite a poison capsule.

As well as these tactical benefits, suicide terrorism offers a strategic one. After the debacle in Somalia in 1993, Mr bin Laden concluded that sensitivity to casualties was the heel of the American Achilles; Palestinian terrorists think something similar about Israel. Suicide bombings juxtapose these groups' disdain for life with their victims' supposed love of it. This helps to create the impression of an undeterrable enemy, one freed by his self-disregard to strike anywhere: “I depend on death,” says a would-be suicide bomber in “The Secret Agent”, “which knows no restraint and cannot be attacked.”

Simultaneous bombings magnify this sense of vulnerability; so do sequences of attacks. As Mr Pape observes, almost all suicide missions occur as part of campaigns, often, as with the regular attacks on the Americans and their allies in Iraq, designed to liberate territory occupied by democracies. (Democratic governments, it is presumed, are more likely to be swayed by their citizens' deaths than others.) The cumulative effect of such campaigns was aptly described by Josephus, a classical historian who chronicled the anti-Roman insurgency in Judaea: “The panic created was more alarming than the calamity itself; everyone, as on the battlefield, hourly expected death. Men kept watch at a distance on their enemies and would not trust even their friends...” Everyday activities become perilous; ordinary life begins to seem untenable.

AP

Targetting commuters near Chechnya

Terrorists have some reasons to believe that such onslaughts work. Chief among those is the withdrawal of French and American forces from Lebanon after Hizbullah's atrocities. “We couldn't stay there and run the risk of another suicide attack on the marines,” wrote Ronald Reagan, then America's president, in his memoirs. Other apparent concessions to suicide campaigns, such as temporary Israeli withdrawals from Palestinian territory in the mid-1990s, have been more ambiguous; but terrorists tend to interpret history in a way that burnishes their own efforts. For their part, the *kamikaze* pilots helped to convince America that Japan would fight to the last soldier. This conviction was partly why atomic bombs were dropped on Hiroshima and Nagasaki.

Finally, like other forms of terrorism, suicide attacks are designed to impress the terrorist's own constituency, as well as to coerce their opponents—and “martyrs” have a particular propaganda value. Some groups have embraced suicide to keep pace with rival outfits, with whom they are competing for recruits and support. This was the case in Lebanon, where other organisations, including some secular ones, imitated Hizbullah's new technique. Likewise, various offshoots of Yasser Arafat's Fatah movement, which once preferred ambushes and guerrilla attacks, took up “martyrdom operations” after the suicidal “successes” of PIJ and Hamas.

Will the bomber always get through?

The prevalence of suicide in contemporary terrorism has helped to persuade some observers that outrages from Rabat to Riyadh to Grozny are all the handiwork of al-Qaeda—just as, in the 1980s, conspiracy theorists believed that terrorism across the globe was being orchestrated by the Soviet Union. This sort of talk suits Mr bin Laden; and the idea of a single, coherent enemy also has some appeal for westerners. In reality, suicide has spread not because of central co-ordination, but because it works. The term “suicide bombing”, with its connotations of unhinged despondency, obscures the essential rationality of the method. Some in Israel and America, arguing that it also obscures the victims, prefer

“homicide bombings”.

How can the targets of such attacks protect themselves? By picking on democracies, the terrorists can be reasonably sure that their adversaries will stop short of “the Mongol method” (ie, wholesale slaughter of the population from which the bombers derive). Even so, suicide campaigns are often designed to madden their victims into inflicting collective punishment, thus further radicalising the terrorists' actual or potential supporters, who might otherwise be repulsed by the carnage that such extreme violence causes.

But there are subtler methods. Because they are corporate enterprises, disrupting or preventing attacks is not just a question of catching the bomber: there are also recruiters, trainers, reconnaissance agents, bomb-makers and safe houses. Israel prevents many attacks by penetrating these networks—though as Shlomo Gazit, a former head of military intelligence, points out, Israel knows roughly where its enemies can be found, and so can monitor their movements and cultivate informers. Police in, say, London or New York do not enjoy that luxury.

Israel's checkpoints and cordons (also unlikely to be emulated elsewhere) intercept some killers; they also reassure the public that something is being done, thus countering the terrorists psychologically as well as militarily. Even when the bomber gets through, vigilant security guards who manage to keep pedestrian attackers out of restaurants or discotheques can massively reduce the number of casualties. Other sensible defensive measures include the rapid dispersal of crowds at the scene of an explosion, to protect them from follow-up strikes.

Such vigilance can make life grindingly tense. If possible, the best answer must be to choke the supply of the terrorists' prize asset—the bombers—through political compromise. Yet against the ultra-extremists of al-Qaeda, intelligence, disruption and vigilance may be the only ways.

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George Bush's big-government conservatism

Can't last

Jan 8th 2004 | WASHINGTON, DC
From The Economist print edition

Between 1998 and 2001, America's federal government ran a surplus on its accounts. The prospect now is of years, even decades, of deficits. Is that scary?

Get article background

IN HIS first three years as president, George Bush has cut taxes three times and yet orchestrated a sharp rise in public spending—not just, or indeed mainly, on foreign wars and "homeland security", but also on domestic matters. For instance, spending on education has jumped by three-fifths since 2000, and spending on transport has risen by nearly half. Lower taxes, higher spending: the outcome is that the federal government, despite a steep fall in the interest it pays on its debt, has swung sharply into deficit—$450 billion this fiscal year, by most accounts.

That is not, yet, as big a deficit as that presided over by Ronald Reagan in 1983 (6% of GDP then, compared with about 4% of GDP for this year). Yet the deterioration of the government's finances today—from a surplus of 2.4% of GDP in the 2000 fiscal year—is certainly steeper.

What is more, by 1983 Mr Reagan and Congress were together attempting to do something about the deficit. Nowadays, no one with political power is bothering to try. All the Democratic presidential hopefuls want, to a greater or lesser degree, to repeal Mr Bush's tax cuts. Yet they aim to use the money not to bring down the deficit, but to expand public programmes. Mr Bush's own new legislation to pay for prescription drugs under Medicare, the federal health programme for the elderly, will cost $400 billion over the next ten years. A bipartisan conspiracy exists, it seems, to ignore the risks of a widening deficit.

What risks? After all, a year or two of sharply higher government spending in the early part of Mr Bush's presidency—when economic growth slowed sharply, a stockmarket bubble burst, and America faced unprecedented and confidence-sapping security threats—may well have been for the good. Yet, even as evidence grows that there is a reasonable chance of economic recovery, the long-term prospects for the budget look as bleak as ever.

A new and frank report by the Congressional Budget Office (CBO) shows that rising health-care costs and an ageing population mean that federal "entitlement" programmes—notably for Medicare, Medicaid and Social Security (pensions)—will claim a much higher share of the country's economic output over the coming decades. Currently, Social Security funds run a surplus that helps to finance other parts of government. But by 2015 surplus will swing to deficit, and by 2030, on current policy, the cost of Social

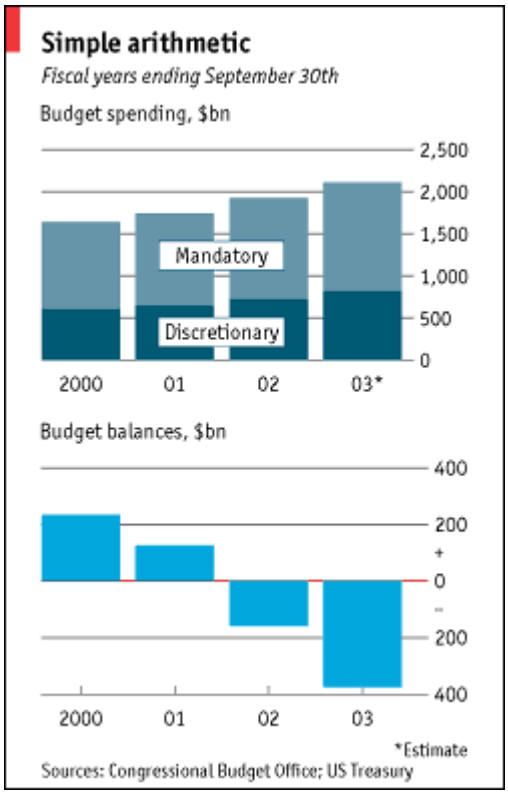
Security will have risen from 4.2% of GDP to 5.9%.

Spending on pensions pales in comparison with health care. The range of estimates is necessarily vague, since they involve assumptions about the future rate at which health-care costs will grow faster than per-head GDP each year: since 1970, the “excess-cost growth” for retired people on Medicare has been around 3%. The CBO calculates that, if future excess-cost growth of both Medicare and Medicaid was only 2.5%, then federal spending on these programmes would jump from 3.9% of GDP in 2003 to 21% in 2050.

It is clear that holding back the growth in non-entitlement (or “discretionary”) programmes, such as defence and transport, will not be enough to ensure a sustainable budget in the long run. Unless entitlement programmes are cut too, or taxes raised to unprecedented levels, or both, the country is on a financially unsustainable path over the next half-century. “An ever-growing burden of federal debt held by the public”, the CBO concludes, “would have a corrosive and potentially contractionary effect on the economy.”

Some observers go further. In a paper presented to the American Economic Association last Monday, Peter Orszag of the Brookings Institution, Allen Sinai of Decision Economics and Robert Rubin, one of Bill Clinton's treasury secretaries, say that “substantial deficits projected far into the future can cause a fundamental shift in market expectations and a related loss of confidence both at home and abroad”—in other words, a full-blown, third-world-style financial crisis. Impishly, they quote Greg Mankiw, now Mr Bush's chief economic adviser, in a paper he co-wrote in 1995: “We can only guess what level of debt will trigger a shift in investor confidence, and about the nature and severity of the effects. Despite the vagueness of fears about [these effects], these fears may be the most important reason for seeking to reduce the budget deficits.”

The White House claims that the budget it is preparing for the 2005 fiscal year will be “committed to fiscal restraint”. But this is an election year, after all. A report in the *New York Times* suggests that the administration will claim to be able to halve the deficit over five years by relying on future economic growth and on cruel cuts in such programmes as housing for the poor and job-training for the unemployed. Certainly, these vulnerable groups do not tend to vote Republican. Also certainly, such cuts will barely dent the budget deficit.



Fortunately, others are thinking more seriously about the choices that need to be made to secure long-term deficit reduction. In “Restoring Fiscal Sanity”, a report to be published on January 13th by the Brookings Institution, edited by Isabel Sawhill and Alice Rivlin, once Mr Clinton's budget director, three options are offered.

The “smaller government” path emphasises cuts in “corporate welfare” (subsidised insurance, loans, etc), the devolution of responsibilities to the states, savings from that old chestnut of “waste, fraud and abuse”, and deep cuts in entitlements. The “larger government” path emphasises tax increases as the main route to sustainability. The “better government” path argues, in Clintonian style, that the government can be more effective without absorbing a larger share of GDP. The problem with this path, as the authors admit, is the difficulty of measuring the effectiveness of various government programmes, and of dealing with resistance to cutting them.

Given such resistance, it is more likely that higher taxes will play the largest part in plugging the deficit. The question, then, is whether the process of plugging begins sooner or later. Either way, Americans will soon have to accept that federal spending is rising to a permanently higher level, one closer to European levels of government spending. Perhaps they can soften the shock by taking their holidays in Paris.

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California

Last Action Hero

Jan 8th 2004 | LOS ANGELES
From The Economist print edition

Now he's governor, the film man's muscle turns out to be real

Get article background

AFP

Preparing to bite the bullet

“WOW, this feels good!” Hardly the expected opening words from a governor giving his first “state of the state” speech—especially when the state in question, California, is deep in debt and riven by quarrels. But Arnold Schwarzenegger, elected last October, is full of beans after a Christmas break in Sun Valley, Idaho. Will he still feel as buoyant in July, when one fraught financial year leads on to another?

The answer depends on how destructively a Democrat-dominated legislature deals with the 2004-05 budget proposals, announced on January 9th (after *The Economist* went to press), of the Republican governor. At worst there could be a head-on collision between Democratic lawmakers determined to keep spending and a governor determined to restrain it. When Mr Schwarzenegger said in his January 6th address that “if we continue spending and don't make cuts, California will be bankrupt,” the immediate reply from Herb Wesson, the Democratic speaker of the lower house, was a pledge that “we will not capitulate on Democratic core values.” Cue, as one observer puts it, for a “long, hot summer”.

Yet the gloomsters may be wrong. One reason is that even the most arrogant lawmakers are aware of their collective unpopularity (their opinion-poll ratings last year were even lower than those of ex-Governor Gray Davis). The bigger reason, however, is that Mr Schwarzenegger is proving a lot more adept than his critics had imagined. Last November, on his very first day in office, he kept one campaign promise by cancelling a tripling of vehicle-licensing fees. A second promise kept was a special session of the legislature, in which the charismatic Mr Schwarzenegger charmed the lawmakers first into repealing plans to give driving licences to illegal immigrants and then into approving his “California Recovery Plan”—a programme which seeks simultaneously to put a constitutional limit on spending, build up a reserve fund and refinance the state's present debts with a bond issue of up to $15 billion. Another part of the plan is a pledge to overhaul the workers' compensation system; employers' costs for this in California are double the national average.

Put that record together with signs that the state's teachers have been persuaded to accept a temporary cut in education spending, and Mr Schwarzenegger may be on a winning streak. After all, in the end the key to his success or failure lies with the people, not the politicians.

The recovery plan's spending cap and the $15 billion “recovery bond” will come into law only if they are approved in a public vote on March 2nd—which is why the governor is urging the lawmakers to campaign for it. Moreover, if the lawmakers disagree with the governor's plans for workers' compensation, let them come up with their own ideas by March 1st, and let the ideas amount to real reform. “If modest reform is all that lands on my desk,” says the governor, he will take his own solution directly to the people in November.

Fair enough, but Mr Schwarzenegger and his advisers (many of them connected to the last Republican governor, Pete Wilson) know that success at the ballot box will not be enough. With the $15 billion bond issue, says Mr Schwarzenegger, “we will have dodged the first bullet, the 2003-04 budget deficit. But the second bullet—the second financial crisis—has already left the barrel and is headed right at us.” Indeed: the 2004-05 fiscal year will start with a $15 billion deficit, $11 billion of it structural and the other $4

billion because of the loss of the vehicle-licence fee.

But do not despair, says the governor. A better business climate will bring jobs and tax revenues; a cap on spending will reassure Wall Street. And meanwhile Arnie will travel the world selling California's virtues. “If I can sell tickets to my movies like ‘Red Sonja' or ‘Last Action Hero', you know I can sell just about anything. California is the easiest sell I've ever had.”

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Immigration

Amnesty international

Jan 8th 2004 | WASHINGTON, DC
From The Economist print edition

At last, sense about illegal workers

Get article background

AT THE height of the Republican Party's bitter internal debate over immigration in the 1990s, the young governor of Texas sided firmly with the pro-immigration forces. “Hell, if they'll walk across Big Bend”, he said, “we want 'em.”

As president, George Bush floated the idea of a guest-worker programme to reform America's ramshackle immigration system. September 11th forced him to shelve it. Now he has proposed the biggest overhaul of America's immigration laws for almost 20 years.

The basic idea is to grant temporary legal status to people who are working in the United States illegally. All the illegal workers have to do is to prove that they have a job. They will then be given work permits that will give them the right to work legally for three years—and which can be renewed an unspecified number of times thereafter. Foreigners who prove that they have job offers from American employers can also take part in the programme.

There are currently somewhere between 8m and 12m illegal immigrants working in the United States, half of them from Mexico. Mr Bush's proposals will help to rescue them from the shadows. They will be entitled to regular benefits such as minimum wages and due process. They will be able to travel back and forth to their native country, and will not be precluded from applying for green cards granting permanent residence.

The proposals are far from perfect. Critics such as The National Council of La Raza, a Latino pressure group, argue that illegal workers might be putting themselves at risk by applying for temporary residence. Why not continue to work illegally, rather than run the risk of being denied a green card and forced to return to your native country?

But, for all their vagueness, Mr Bush's proposals are clearly an improvement on the current situation. The proposed legislation could do a lot to repair America's badly damaged relations with its southern neighbour. Mr Bush's honeymoon with the Mexican president, Vicente Fox, came to an abrupt end when the United States shelved earlier plans for immigration reform (and when it later invaded Iraq). Mr Bush's proposals will also be a huge boost to Mr Fox personally. The upcoming meeting between the two men in Monterrey is likely to be a love-fest.

But in a re-election year the most important consequences are clearly for the Latino vote at home. Latinos, America's fastest-growing minority, have gone from just 2% of the electorate in 1988 to an estimated 9% in 2004. They are also much less set in their voting ways than blacks. Mr Bush won 35% of Hispanic voters in 2000 compared with Bob Dole's 21% in 1996. The White House hopes that its willingness to address a problem that is close to the hearts of most Latinos will help the Republicans handsomely in such hotly contested states as Florida, New Mexico and Nevada.

The proposal is not guaranteed an easy ride. Mr Bush is leaving most of the details to Congress, and many members wish to throw spanners in the works. Yet the president has an important ally in Bill Frist, the Senate majority leader, who was in Mexico this week to drum up support for the plan. As the man responsible for steering legislation through the Senate, Mr Frist thinks he might even get this bill home and dry before the election.

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Half-changed Milwaukee

Hard act to follow

Jan 8th 2004 | MILWAUKEE
From The Economist print edition

Exit that interesting character, a tight-wallet socialist

AP

Norquist's tragedy: new urbanism meets old urges

WHEN 250,000 bikers roared into this mid-western city to celebrate Harley-Davidson's centenary a few months ago, Milwaukee had a chance to recall its origins as a city of heavy industry and flowing breweries. What a difference a century makes. Today it boasts a lake-front art gallery designed by a Spanish architect, Santiago Calatrava, a dozen theatre companies, a river-front that lures tourists and residents to eat and play by the water (at least in the few warm months), and a former warehouse district full of art galleries and homes for young professionals.

The transformation is generally credited to John Norquist, a tall, outspoken intellectual who last month resigned from the mayorship after 16 years. The longest-serving mayor of a large American city, Mr Norquist espoused something called “new urbanism”— the idea that the potential of a city can be unleashed by good design and planning—and coupled it with a firm belief in free markets. He sought to put an end to monopolies, and kept on lowering taxes even while maintaining the city's services. He was, he explained to the world, a fiscally conservative socialist.

But this versatile fellow has given up the mayor's job four months before the end of his fourth term, leaving under a cloud of scandal. A married father of two, he had admitted a sexual relationship with an aide, to whom he agreed to pay $375,000. Marvin Pratt, the president of the city's Common Council, was sworn in as acting mayor on January 2nd, the first black to sit in the mayor's office of a city whose population is 37% black. Some 17 candidates will run for the job in April.

Many people admire the new Milwaukee. David Gordon (a former chief executive of *The Economist*), who went there to run the revamped Milwaukee Art Museum in 2002, recalls that he once wondered: “Milwaukee—where the hell is that?” Today he is a leading backer of the revival of the city's centre. His museum drew about half a million visitors last year, three times as many as before it was redesigned by Mr Calatrava.

But not everyone is so positive. Under Mr Norquist, the city attracted national attention with a project that uses taxpayers' money to let a relatively small number of poor families send their children to private schools. The mayor does not have direct control over Milwaukee's schools, but Mr Norquist backed candidates for the independent school board who shared his views on the subject. Unfortunately, it is still not clear whether the programme is really achieving what he wanted.

Mr Norquist's critics—ranging from teachers to suburban Republicans—also point to the still-huge gap between blacks and whites in jobless numbers, teenage pregnancies and school drop-outs. His outspokenness has not helped. “John was almost too bright for his own good,” says Mordecai Lee, a university teacher who served with him in the state legislature. He calls him “a policy wonk who didn't have the basic talent of compromising”. True to his passion, Mr Norquist has gone to Chicago to run a group called Congress for the New Urbanism.

The next mayor faces some daunting challenges. Pensions and health care need more money, but the Norquist legacy makes it hard to raise taxes. And, gleam though its smart downtown area now does, a city which is more than half non-white needs to do something for the neighbourhoods that have yet to

share the satisfaction of the downtown renewal.

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Texas redistricting

The map of victory

Jan 8th 2004 | AUSTIN
From The Economist print edition

A very good day for Tom DeLay

Get article background

IT MIGHT seem that Texas Republicans have nothing left to win. They have the White House and the vice-presidency, every statewide office in Texas, both houses of the state legislature, one of their own as House majority leader in Washington, and even a favourite son at the helm of the Commerce Department. But a federal court's decision last week to uphold a pro-Republican redistricting plan could be the gift that keeps on giving, long after George Bush has left Washington.

Little wonder that the Democrats, who had staged quorum-busting walk-outs to neighbouring states and organised a storm of expensive lawsuits, are so desperate to stop the redistricting plan. If the Supreme Court does not intervene in the next few days, the new map could make it impossible for them to take control of the House for a decade or more. And, with an expected seven new Texas Republicans in Washington, the Democrats rightly fear that the House majority leader, Tom (“The Hammer”) DeLay, may soon become the first Republican speaker from Texas. After all, the map is his baby, and the new congressmen will owe him their jobs.

The ruling was no shocker. The Justice Department, which must approve big election changes, had already given its blessing. Sensing the inevitable, one long-serving Democratic congressman has just switched parties, leaving the 32-member Texas delegation evenly split.

The court that upheld the plan, composed of two Republican appointees and one Democrat, at times seemed hostile to Democratic lawyers. At one point during the trial, Judge Patrick Higginbotham sneeringly but aptly reminded them that, back when they held power, “You rewarded your friends and punished your enemies. When did this tradition of fair play across the aisles come to Texas?”

Democrats complain that the decision guts the 1965 Voting Rights Act, which came in to protect black and Hispanic voters and more recently enshrined majority-minority congressional districts as virtually untouchable. Congressman Martin Frost, a Democrat from a heavily minority district in Fort Worth, said the ruling “turns back the clock on nearly 40 years of progress” for minorities. But not even the single Democratic judge supported him.

Losing that one, the Democrats also argued that legislatures should be able to redraw the congressional map only immediately after the decennial census. Otherwise, they complained, the Texas experience could spread, bringing non-stop redistricting and political instability. The court thought that a good argument, but one with no legal basis. “We decided only the legality of the plan,” the judges said, “not its wisdom.”

Of course, as the court noted, Congress has the power to ban mid-decade redistricting any time it sees fit. And if the Democrats ever clamber out of their death spiral and take back the map-drawing Texas legislature, that's a power even Tom DeLay might grow to love.

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Pete Rose's revelations

Okay, I'm guilty

Jan 8th 2004
From The Economist print edition

Now let me into the Hall of Fame

BACK in 1989, when Pete Rose, then manager of the Cincinnati Reds, was accused of gambling on baseball games, it was “not unlike the fall of man”, says one disconsolate Reds fan. Mr Rose held (and still holds) the all-time record for the most hits in his career, beating even Ty Cobb and Hank Aaron. But baseball's commissioner, though he never publicly produced evidence of his betting, banned him from the game for life.

Mr Rose said the bigwigs were wrong. “I did not bet on baseball. I have too much respect for the game,” he said in 1989. He produced an autobiography saying much the same. At a time when casinos were spreading across the country, fan clubs sprang to his defence (“So what? Everyone gambles.”).

But suddenly Mr Rose has changed his mind. His new autobiography, “My Prison Without Bars”, came out on January 8th. In it Mr Rose, now 62, admits publicly for the first time to betting on his Reds (though never of course that they would lose) and on other teams. “I'm sorry it happened,” he writes, according to excerpts published in *Sports Illustrated*. “I never allowed my wagers to influence my baseball decisions. So, in my mind, I wasn't corrupt.”

That is hardly convincing. Apart from the pile of money he will make in bookshops from coming clean, consider Mr Rose's sorry record: besides gambling illicitly on games, and lying about it for 14 years, he spent five months in jail, in 1990, for false statements on a tax return.

So what now of his hopes of the Baseball Hall of Fame? Normally he would be a shoo-in, but he is ineligible because he is banned from the game. His best chance to be voted in (by the Baseball Writers' Association of America) expires in 2005, and other groups that can vote him in are loudly against doing so. Bud Selig, the present commissioner, is said to be thinking of reinstating Mr Rose now he has fessed up. This could allow him a final bid for glory, and a chance to coach again.

Fans would love this. Opinion polls have always shown large majorities in favour of his reinstatement, even if he admitted to having gambled. He warmly agrees: “For the last 14 years I've consistently heard the statement: ‘If Pete Rose came clean, all would be forgiven.' Well, I've done what you've asked,” he says in the new book. A bit late, you may think.

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Lexington

The curse of nepotism

Jan 8th 2004
From The Economist print edition

A helping hand for those who least need it

AMERICA likes to think of itself as the very embodiment of the spirit of meritocracy: a country where all people are judged on their individual abilities rather than their family connections. The American Revolution swept away the flummery of feudal titles. Thomas Jefferson dreamed of creating a “natural aristocracy”. Benjamin Franklin sniped that “a man who makes boast of his ancestors doth but advertise his own insignificance.”

The Founding Fathers had a rather narrow view of who should be admitted to their meritocratic republic, to be sure. But today most Americans believe that their country has done a reasonable job of getting rid of the most blatant forms of discrimination towards blacks and women and building a ladder of educational opportunity. Americans are far more confident than Europeans that people deserve what they get in life.

But are they right? The more you look at modern America, the more you are struck by how frequently it departs from the meritocratic ideal. George Bush's Washington is a study in family influence: look at the Powells, the Chao/McConnells, the Scalias and the Cheneys, not to mention the Shrub himself.

The biggest insult to meritocracy, however, is found in the country's top universities. These institutions, which control access to the country's most impressive jobs, consider themselves far above Washington and its grubby spoils system. Yet they continue to operate a system of “legacy preferences”—affirmative action for the children of alumni.

These preferences are surprisingly widespread. In most Ivy League institutions, “legacies” make up between 10% and 15% of every freshman class. At Notre Dame they make up 23%. They are also common in good public universities such as the University of Virginia. Legatees are two to four times more likely to be admitted to the best universities than non-legatees.

America's universities are probably the most politically correct places on the planet. So what are they doing pandering to the (overwhelmingly white) children of the overclass? University administrators offer two justifications. The first may be crudely characterised as fund-raising. Universities are always asking their alumni for a helping hand and for money. The least the alumni can expect in return is that the universities will take a careful look at their college-age offspring.

But is it reasonable for universities to use their admissions systems as tools of alumni management—let alone fund-raising? Universities are supposed to be guardians of objective standards. They are also the recipients of huge amounts of public money as well as private donations. In short, there is no need to.

The second justification is that alumni preferences aren't really preferences at all. William Fitzsimmons, dean of admissions at Harvard College, considers them simply an “ever so slight tip”. He admits that 40% of the children of alumni get into Harvard compared with only 11% of ordinary applicants, but says that is mainly because of self-selection. Successful legatees have almost the same test scores as successful non-legatees.

Given the secrecy of the admissions process, this argument is hard to verify. It is worrying that a Department of Education report in 1990 concluded that the average Harvard legacy student is “significantly less qualified” than the average non-legacy student in every area except sports. But even if you give Harvard the benefit of the doubt, the system is still a disgrace. This is a university that has to turn down more than 2,000 high-school valedictorians every year. If you are going to offer a “slight tip” to anyone, why offer it to people who are already on the inside track—who not only come from privileged homes, but also have an insider's knowledge of how the admissions system works?

There are signs that patience with this practice is wearing thin. John Edwards has made it a theme of his presidential campaign, denouncing it as “a birthright out of 18th-century British aristocracy, not 21st-century American democracy”. Teddy Kennedy has drafted a bill that will force universities to publish data on the racial and socio-economic make-up of their legatees.

Political inbreeding

But there are two big obstacles to the Democrats rallying around the banner of meritocracy. The first is that the left overwhelmingly supports affirmative action for minorities, a policy far more acceptable than affirmative action for the rich, but which rests on the same belief that people should be judged on something other than their individual abilities. If the Supreme Court had ruled against affirmative action earlier this year, the legacy system would have been next in the firing line; but in reprieving affirmative action, the court also reprieved the legacy system.

The second reason is that much of the Democratic establishment is also riddled with nepotism. Howard Dean was a legatee at Yale University, just like George Bush. The front-runner for the Democratic presidential nomination in 2008 is Hillary Clinton. Nancy Pelosi, the Democrats' leader in the House, is the daughter of a five-term Maryland congressman turned Baltimore mayor—and one of her chief challengers for the job was Harold Ford, who succeeded his father in a Tennessee seat.

Perhaps Teddy Kennedy's name-and-shame strategy will have the desired effect. Perhaps an infusion of new blood will make American politics a little less inbred. Perhaps an improvement in inner-city schools will mean that affirmative action can be allowed to wither on the vine. But none of this seems very likely. For most of its life, America has usually been marching towards the meritocratic ideal. Now it is getting harder to ignore the accusation that it is slouching in the opposite direction.

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Correction: “The King of K Street”

Jan 8th 2004

In our November 8th Lexington column, “The King of K Street”, we should have cited, along with our other sources, Nicholas Dawidoff's article “Mr Washington Goes to Mississippi” from the October 19th issue of the *New York Times Magazine*. Our apologies.

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Colombia's security policy

You do the maths

Jan 8th 2004 | BOGOTÁ
From The Economist print edition

AFP

Despite its shortcomings, President Uribe's security push has achieved some promising results

Get article background

AFTER months of effort by Colombian agents aided by the United States, Ricardo Palmera (above) was finally arrested in Ecuador on January 2nd. Mr Palmera, whose *nom de guerre* is Simón Trinidad, is the most senior leader of the FARC, Colombia's main rebel group, to be captured during its long war with the government in Bogotá. His capture is a symbolic victory for President Álvaro Uribe; and partly because of America's help, there have been many other (if less dramatic) gains.

If ending Colombia's violence were simply a question of numbers, then 2003 offered many reasons for hope. Jorge Alberto Uribe, the defence minister since November (no relation of the president), has his own tally. Last year, over 16,000 suspected members of the country's two leftist guerrilla groups, and of its right-wing paramilitary vigilantes, either surrendered or were killed or captured. That amounts to more than half of the three irregular armies' estimated total strengths. Keep this up, and they will soon be wiped out: “It's mathematics,” says Mr Uribe.

If only. Colombia will remain a violent country for years to come: the drug trade will see to that. Yet the president's “democratic security” policy has indeed notched up some impressive results. Colombia's overall murder rate fell to around 50 per 100,000 people in 2003—still high by international standards, but the lowest figure since 1986, according to Fundación Seguridad y Democracia (FSD), a Bogotá consultancy. For the first time in recent years, the number of new internal refugees caused by the violence fell substantially, to 156,188. According to new government figures, there were a mere 2,043 kidnappings in 2003, down from 2,986 in 2002.

Meanwhile, the security forces have been busy: they fought more than 2,300 battles with the irregular armies (up from 1,338 in 2002), losing 523 dead while killing 2,980, according to FSD figures. And a massive campaign of aerial spraying has cut the cultivation of drug crops, on which the rebels rely for income.

Behind the figures lies a big security build-up, supported by American aid totalling around $2.5 billion since 2000. President Uribe's strategy has two main elements. First, the armed forces have taken the offensive. In the second half of 2003, the army and air force did much damage to FARC units in north-western Colombia, around Bogotá and Medellín. They killed or forced the surrender of half a dozen mid-

level guerrilla commanders. This has helped to blunt FARC's efforts to mount an urban bombing campaign.

Second, the government is attempting to recapture territory, and establish a presence throughout the country. A plan to expand the police was completed last month, with contingents placed in all 158 municipalities that lacked them when the president took office in August 2002—no small matter in a country more than twice the size of France. In some places, the police are being backed up by a new force of local part-time “peasant soldiers”.

The omelette and the broken eggs

Ordinary Colombians feel safer, and, partly as a result, the economy is reviving. GDP grew by an estimated 3.2% last year, the best posting since 1997. Juan Carlos Echeverry of LatinSource, a New York-based consultancy, points out that the capital flight of recent years has now been reversed, and investment and imports of capital goods are both growing.

Yet this progress is not without flaws; and it is too early to be sure that it is irreversible. The government has yet to hit FARC where it would hurt most: its longstanding bastions in the south and east, in departments such as Meta and Caquetá. This is where the guerrillas have their training schools, weapons factories and arms dumps, and garner some support from the local population.

Mr Uribe, the defence minister, points to recent combat in Putumayo, a FARC stronghold in the south. A shake-up in the armed forces has brought generals to the two top posts who spend more time in the field than at their desks. And Congress last month approved a new anti-terrorism law that gives the army judicial powers, of arrest and search, as well as phone-tapping. Mr Uribe insists that the powers will be temporary (the law expires in four years), will be used only against “terrorism”, and will be subject to congressional oversight. But human-rights groups say they will lead to an increase in torture and forced disappearances. Any such heavy-handedness will carry political, as well as ethical, risks. The president already faces criticism for a hasty effort to give an amnesty to right-wing paramilitaries, who have a murderous past and links to some army officers.

Perhaps the weakest part of the security strategy is its approach to the civilian population in guerrilla areas. In a downbeat recent report, the International Crisis Group, a Brussels-based watchdog, lamented the government's lack of a rural-development strategy, and concludes that “lasting gains against the insurgents will be difficult, if not impossible, unless rural communities see clear and immediate benefits in the government campaign.” A hefty commission organised by the Council on Foreign Relations in New York this week made some similar points.

Minister Uribe admits that “the social touch” is important. But boosting local government, schools and hospitals is expensive. And while the president remains very popular, he has stumbled recently. A referendum in November on fiscal reforms, promoted by him, failed when too few Colombians voted. To reduce the resulting fiscal gap, the president asked Congress to approve tax increases. It did so, but different ones, including a wealth tax.

If the president is no longer omnipotent, that is no bad thing. The main thrust of his security policy is sound, but it needs to be refined if the undoubted progress towards making Colombia a peaceful democracy is to be consolidated.

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Mexico's film industry

San Miguelwood

Jan 8th 2004 | MEXICO CITY
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A new home for Zorro and Pancho Villa

SAN MIGUEL DE ALLENDE, probably Mexico's most alluring colonial town, has long been a favoured destination for rich Americans seeking a gentler life, as its rocketing house prices and a critical mass of French restaurants attest. Work is just about to begin on a new 18-hole golf course, a sure sign of gringo infiltration. Recently, however, the town has become familiar to millions more gringos as the backdrop for a series of pistol-and-moustache feature films.

Which way to the French restaurant?

Antonio Banderas, a Spanish actor, is a repeat visitor: his “Once upon a time in Mexico”, plus a television biopic of the revolutionary hero Francisco “Pancho” Villa, and the forthcoming “The Mask of Zorro II”, all utilise San Miguel's sumptuous buildings and cobbled streets. Now a group of entrepreneurs is harnessing American money and know-how, plus the town's burgeoning cinematic reputation, to open the country's first privately financed studio complex, called The Film Colony. A 250-acre site on the edge of town has been cleared, and the first building (the restaurant, naturally) is due to go up soon.

At a total cost of $48m, the project dwarfs even the old government-run film facilities in Mexico City. The Film Colony will have six sound stages—enough to make two James Bond films at the same time. It will also have a film school for up to 350 students, and on-site accommodation to look after them and the talent that is supposed to flock in.

The project's director is a New Zealander, Francesca Fisher, who already runs her own film-production company in Mexico. She says she has long encountered “quite a lot of resistance to filming in Mexico City” among Americans. The capital is cheap, but its facilities are crumbling and its traffic horrendous. Ms Fisher thinks she can lure most visiting productions up to the colonial splendour and relative luxury of San Miguel.

Her timing could also be opportune, because despite the many accolades heaped on recent Mexican productions, the public funding of the old Churubusco studios and government film school in Mexico City is being reviewed by the country's cash-strapped finance ministry. Should the axe fall, San Miguel will likely provide the backdrops for even more swashbuckling romps.

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Paraguay's new president

Winning respect

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From The Economist print edition

Something stirs in a backward country

AP

FEW countries have been as ill-governed as Paraguay, a landlocked and insular republic of 5.5m people, known to the outside world chiefly as a centre of corruption, smuggling and counterfeit goods. Nicanor Duarte Frutos, the president since August, says that one of his aims is to turn his country into a “respectable nation”. Paraguayans have high hopes that he will manage to. So, it seems, does the IMF: last month it granted Paraguay a $73m loan. The Fund's seal of approval should help Mr Duarte avoid default on foreign debt. But his country's troubles run deep.

Paraguay has been ruled by Mr Duarte's Colorado Party since 1947, and for most of that period by a dictatorship. The arrival of democracy, in name at least, in 1989 did not prevent mounting economic problems. A slump, aggravated by the travails of neighbouring Argentina and Brazil, has meant that income per head has fallen dramatically since 1996. The public finances remain fragile. The Colorados, whose political power rests on the loyalty of a bloated civil service, have reneged on repeated promises to reform the state.

Mr Duarte pledges to be different. He is no “neo-liberal”, but he does claim to be a reformer. He quickly reached agreement with private banks to restructure $138m in government bonds. He has made ambitious promises to the IMF, including one to eliminate the fiscal deficit by 2004. His government is cracking down on tax evasion: only 30% of tax due is paid, according to one estimate. Dionisio Borda, the well-respected finance minister, is seeing through a bill to introduce an income tax and scrap tax breaks, though implementing it in such a primitive country may prove tricky.

Meanwhile, Mr Duarte is trying to hold down spending. This year's budget involves austerity without reform, and the cuts have fallen on social spending. But he saw off a strike by teachers, provoked by a plan to reduce the deficit in their state-funded pension scheme by raising the retirement age and increasing contributions.

And the president says he is determined to tackle corruption. He was quick to sack several tainted officials, including some personal friends. Like Néstor Kirchner in Argentina, Mr Duarte is pressing for a clean-up at the Supreme Court: four justices have resigned and two—including the Court's president—have been impeached. As in Argentina, a reformed Court may be good for public hygiene, but not necessarily for judicial independence. Cleaning up the police will be an Augean task.

Mr Duarte is also venturing abroad. He is keen to have close relations with Brazil and Argentina, Paraguay's partners in the Mercosur trade block. He met George Bush during a recent visit to Washington—becoming the first Paraguayan leader to hold a tête-a-tête with an American president.

Yet at home, many of Mr Duarte's plans face opposition in Congress, where he has only a narrow majority. He is a more skilful politician than his predecessors, and is popular, too: his approval rating in a recent poll was 63%. But ordinary Paraguayans want more jobs, and better health care and education. They are worried by a rise in violent street crime and kidnappings, previously rare. Some say that Mr Duarte is a good talker but slow to act. All the same, something is stirring in Paraguay.

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Canadian cities

Cities in a state

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From The Economist print edition

Canada's picturesque but neglected cities are revolting

Reuters

But the view is wonderful

QUEBEC CITY on its rocky bluff; Toronto by its lake; Ottawa and Winnipeg at the confluence of major rivers; most majestic of all, Vancouver stretched between mountain and ocean: Canada's cities are beautifully situated. But their public services are much less impressive. During his leadership campaign last year, Paul Martin, the new prime minister, pledged to find massive funds for urban renewal, and to improve the lot of Canada's increasingly restive urban-dwellers. Yet Mr Martin himself deserves a share of the blame for the cities' problems.

As finance minister for nearly nine years, Mr Martin chopped billions from federal transfers to the provinces to help eliminate budget deficits. The provinces, in turn, offloaded responsibility for a range of social services to local municipalities, and cut their own cash transfers. Figures from the OECD show that, in 1995, federal and provincial funds made up 21.4% of municipal revenues; by 1999 they provided only 16.5%. To compensate, cities and towns raised property taxes sharply. Among federal states that the OECD monitors, the upper levels of government in Canada give least to their cities.

Meanwhile, in population terms, Canadian cities have boomed. A century ago, 80% of the population was rural; today 80% of the country's 31m people live in towns and cities, and half are concentrated in five city-regions. When Canada was born in 1867 and its first constitution written, Toronto comprised some 50,000 citizens; today the Greater Toronto Area is home to 4.6m people, and may be the most cosmopolitan metropolis on the planet. Immigrants, now mostly from Asia, Latin America and the Caribbean, almost all find their way to the bigger cities. But urban roads, sewers, policing, housing and health care have suffered as the demands placed on them have grown.

Canada's constitution has not changed to reflect this urban growth: the cities are still creatures of the provinces. And the premiers of the ten provinces and three territories have not collectively accepted Mr Martin's view that Ottawa should offer direct funding to the cities. Quebec's government argues that it should receive the funds and decide how they are spent.

Urban legends

The cities, however, are revolting. The amalgamation of a dozen or so municipalities into mega-cities—undertaken by the provinces to cut their own costs—has helped to produce a new crop of mayors with big ideas and new influence. The election, in November, of David Miller as Toronto's reforming mayor gave extra strength to a coalition of uppity civic leaders. Glen Murray, mayor of Winnipeg, has called for a new deal to allow “tax shifting”, along Scandinavian lines. He wants to cut property taxes in his city—which, unusually, has a stagnant population—arguing that homeowners and businesses pay too much for their services, and to make up the difference with user fees. For instance, he wants to introduce a liquor tax to bolster the police force, and a hotel tax to help build convention space and develop tourism. Some other mayors disagree. Dave Bronconnier of Calgary is happy to increase property taxes in his booming city and pour the cash into roads.

What will Mr Martin do? More, he implies, than his predecessor, Jean Chrétien, whose planned investment in urban infrastructure lagged well behind independent estimates of what is required to put

the cities right. The new prime minister has hinted that he would allocate half the revenues from a federal fuel tax, worth C$2.5 billion ($1.9 billion) a year, directly to the cities. He has appointed John Godfrey, a well-regarded Ontario MP, as his urban adviser, and persuaded Mike Harcourt, a former premier of British Columbia and once mayor of Vancouver, to chair a high-powered advisory committee on urban issues. Both men will feed ideas to a special cabinet committee on cities, which Mr Martin intends to chair. Canada's mayors expect him to put his money where his mouth was during his campaign.

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India and Pakistan

Back to jaw-jaw

Jan 8th 2004 | DELHI AND ISLAMABAD
From The Economist print edition

AP

Pakistan's Pervez Musharraf and India's Atal Behari Vajpayee have turned away from confrontation. Now they must pick their next step

Get article background

THE leaders of India and Pakistan may both have benefited from their joint announcement on January 6th, at a regional conference in Islamabad, that they are to start talking about issues that have divided the two countries for decades. Atal Behari Vajpayee, India's prime minister, has enhanced his reputation as a peacemaker and international statesman. This appears to have bolstered the already strong position of his Bharatiya Janata Party (BJP) as it prepares for the general election now expected in India in April. General Pervez Musharraf, Pakistan's president, has shown that, in spite of two assassination attempts in the past four weeks, he is starting to address worries at home and abroad about his country being a base for terrorism. He can also now claim, though many are still sceptical, that he is genuine about making peace with India.

The agreement to hold a “composite dialogue”—which is to start next month—goes further than anyone had expected. The joint statement said General Musharraf had reassured Mr Vajpayee that “he will not permit any territory under Pakistan's control to be used to support terrorism in any manner.” Talks between the two leaders in Agra in July 2001 foundered on Pakistan's refusal to offer precisely that assurance. In exchange, Mr Vajpayee agreed to say that “the two leaders are confident that the resumption of the composite dialogue will lead to a peaceful settlement of all bilateral issues, including Jammu & Kashmir, to the satisfaction of both sides.” This implies a recognition by India of Pakistan's interest in any solution to the problem of divided Kashmir, a far cry from its past position that Kashmir was an integral part of India, and that Pakistan should have no say in its resolution.

So far, so good. But the road to peace on the subcontinent has seen many such hopes collapse in anguish.

In 1989, as young prime ministers, Pakistan's Benazir Bhutto and India's Rajiv Gandhi tried to make peace but failed, and the two countries came to the brink of war in 1990. In 1997, Pakistan's Nawaz Sharif and India's Inder Kumar Gujral agreed to a process of dialogue, but relations soured after the BJP came to power in India in 1998 and both countries tested nuclear weapons. In 1999, Mr Sharif and Mr Vajpayee agreed in Lahore to bury the hatchet, but some months later Pakistan—whose army chief at the time was General Musharraf—launched an assault on India in the Kashmir region of Kargil. In 2001, Mr Musharraf and Mr Vajpayee held a doomed summit in Agra, and relations grew much worse the following December when Pakistani-sponsored militants launched a suicide attack on the Indian parliament in Delhi. That attack provoked another near-war, which some feared could have turned nuclear. This

strengthened America's determination to push the two countries into a long-term rapprochement.

The new thrust started last April when Mr Vajpayee announced his readiness to normalise relations with Pakistan on the basis of “trust and sincerity”. General Musharraf responded by saying he was ready for unconditional talks, but India refused while terrorist attacks continued in Kashmir. In November, India offered confidence-building measures, including the restoration of stalled air, rail and sea links, as well as sporting and full diplomatic ties, which Pakistan, after some hesitation, eventually accepted.

Both sides then began to make conciliatory statements in advance of a seven-country conference of the South Asian Association for Regional Co-operation (SAARC), which provided the occasion for the talks and itself launched anti-terrorism and regional trade initiatives. General Musharraf announced “unprecedented flexibility” in Pakistan's historical attitude toward Kashmir by saying that the United Nations resolutions calling for a plebiscite on its future “could be set aside in the interests of a realistic compromise”. India approvingly noted that Pakistan's “mindset seemed to have changed” and acknowledged that fewer militants were entering Kashmir from Pakistan.

The leaders of the two countries now have to decide how to take the Islamabad agreement forward and thwart the efforts of the extremists on both sides who, General Musharraf admitted, would try to derail the peace process. The general is acting from a position of relative strength, despite the two recent assassination attempts. In the past few weeks, he has brokered a deal with Pakistan's parliamentary opposition to amend the constitution and legitimise his seizure of power in 1999. He has also obtained a vote of confidence from parliament, making him, at last, a legitimate president for five years.

Mr Vajpayee's BJPis expected to decide at an executive-council meeting on January 11th to call for India's general election, due to be held by September, to be brought forward. Mr Vajpayee will want to keep the Islamabad momentum going in the approach to the polls, but without doing anything that might be criticised by anti-Muslim hardliners in his Hindu-nationalist party. He also has to decide how to balance internal reforms in Kashmir alongside talks with Pakistan.

In the past, Kashmiris have called either for independence or for a takeover by Pakistan. Extremists still make these demands. But most people in the disputed territory now call, more modestly, for Delhi to give the state of Jammu & Kashmir a high degree of autonomy within India.

Though the Indian government has paid lip-service to this idea, it has made no progress. It is happy enough with the status quo, and has seen little point in making concessions in advance of any negotiations with Pakistan. Nor has it had an obvious interlocutor in Kashmir. The state's present government is regarded as representative neither by the extremists nor by activists in the All-Party Hurriyat Conference, an umbrella organisation of Kashmiri separatist groups. Moderate leaders of the Hurriyat are due to meet L.K. Advani, India's deputy prime minister, soon. But they dare not do so without a nod from Pakistan: two of their leading moderates have been murdered in the past 18 months. Perhaps General Musharraf's next move should be to back this Hurriyat meeting, which could open the way to talks involving more of the interested parties.

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Pakistan's nuclear dealings

Rogues step in

Jan 8th 2004
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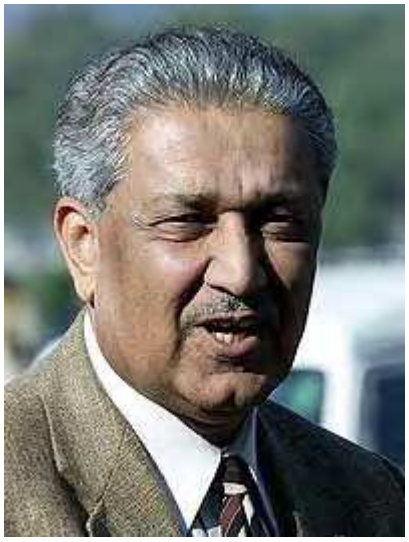
Pursuing personal greed or state policy?

Reuters



Khan built Islam's bomb

Get article background

IS PAKISTAN'S government in proper control of its nuclear establishment or not? President Pervez Musharraf has repeatedly promised that Pakistan, though outside the treaty banning proliferation of nuclear weapons, will not pass on its bomb-making expertise to others. This week, allegations by Bush administration officials and others that Pakistan is the likely source of the uranium-enrichment technology that Libya admitted last month was part of its clandestine effort to build a bomb have been furiously denied by Pakistani spokesmen. Yet the denials are not as confident as they once were: the new line is that such transfers, if they have taken place, must be the work of a few individuals motivated by “ambition or greed”.

Putting the blame on rogue scientists rather than Pakistan as a rogue proliferator hardly removes the doubts about the security of the country's nuclear-weapons programme. The pattern of evidence comes as no surprise to those who track the clandestine trade in weapons technology and materials. In 2002 South Korean intelligence pointed to Pakistan as the source of centrifuge technology for North Korea's production of highly-enriched uranium, which like plutonium can form the fissile core of a bomb. Last October Iran gave the International Atomic Energy Agency (IAEA) the names of individuals and companies that had assisted its hitherto secret uranium-enrichment programme. Some trails, it seems, lead back to Pakistan (but others to Russia, China and companies in Europe).

Suspicion has long fallen on Pakistan's own nuclear-weapons scientists. Several, including Abdul Qadeer Khan, the former head of the laboratory that bears his name and that spearheaded development of Pakistan's nuclear weapons and nuclear-capable missiles, have reportedly been “debriefed” in recent weeks as part of the Iran investigation.

Mr Khan is a national hero, as the father of Pakistan's “Islamic bomb”. He was convicted in absentia in the Netherlands, then later acquitted on a technicality, for stealing the centrifuge designs on which Pakistan's uranium-enrichment programme was based from a company where he worked in the mid-1970s. He has long denied any involvement in nuclear trafficking, official or otherwise. Though General Musharraf removed him from his eponymous laboratory in March 2001, because of American concern about his wider nuclear activities, he remains an adviser to Pakistan's prime minister.

Western proliferation-watchers believe Mr Khan initiated talks with North Korea as early as 1992, on the first of many visits, in order to get his hands on some of North Korea's Nodong missiles, whose range extends to 1,500km (930 miles). Although Pakistan denies it, its Ghauri missile, flight-tested in 1998, is reckoned to be a Nodong knock-off. The deal is thought to have been sealed the following year during a secret visit by Pakistan's prime minister of the day, Benazir Bhutto, whose father had launched Pakistan's secret bid for a bomb in the 1970s. Payment appears to have been in kind: North Korea received its first uranium-enrichment help by 1997. There have been unconfirmed reports that it has also received help in warhead design (Pakistan's warheads fit Nodong-type missiles like a glove).

For its part, Iran has admitted that it first got help for its uranium-enrichment programme in 1987, before Iran and Pakistan found themselves backing opposing sides in the long years of fighting in Afghanistan. The centrifuges it eventually showed to IAEA inspectors last year resemble Pakistani

designs. Both Iran and North Korea therefore got uranium help before General Musharraf became first army chief in 1998 (the army in Pakistan has close control of nuclear-weapons development) and then president in a coup the next year. A Khan lab brochure purportedly offering dual-use nuclear equipment for sale has been in circulation for over a year but is dismissed by Pakistan as a forgery.

But what to make of the Libyan connection? And are more surprises looming?

Libya's uranium dabblings had accelerated in the past two years. Like Iran's they have been partly routed through Dubai, where collaborators at Mr Khan's old laboratory have long been suspected of operating a front company. Iraq, too, said middlemen there offered it nuclear expertise in 1990. Might other countries, such as Saudi Arabia, which like Libya has helped finance Pakistan's nuclear programme for years, Egypt, Syria or Algeria have shown an interest too?

Getting to the bottom of the Pakistan connection may not be easy. General Musharraf is now America's ally in the global war on terrorism. So far, America has taken him at his word that his government is not now engaged in proliferation. Easier, it seems, to blame the scientists.

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North Korea

Another bombshell?

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Diplomacy and threats

IF YOU can't beat them, blame them for the breakdown. That is the game being played out between America and North Korea in efforts to end the crisis over North Korea's nuclear ambitions. This week, amid reports that the six-way talks (also involving South Korea, Japan, China and Russia) were likely to be put off again to next month or beyond, North Korea announced a “bold” concession: as well as freezing its production and testing of nuclear weapons, it will shut down its nuclear reactors even for power generation (though that is something they are not actually equipped to do), in return for a non-aggression pact with America, and much else.

America's Colin Powell called the proposal “interesting”, but is unlikely to jump at it. America wants to talk to North Korea about how it might dismantle both its plutonium production and the uranium-enrichment programme whose belated discovery sparked the latest crisis over a year ago. Only then will America put in writing George Bush's repeated assurance that he has no intention of invading North Korea. Yet North Korea, for its part, now denies that it has a uranium-enrichment programme, even though equipment designed for one has been found on ships heading there.

The gap between the two sides may become clearer after an unsanctioned five-man delegation returns from North Korea this week. The group includes Sig Hecker, a former director of the Los Alamos National Laboratory, and Charles Pritchard, a former State Department pointman for North Korea who has been sharply critical of the Bush administration's Korean tactics since he left his diplomatic post last year.

Is the invitation to the group a sign that North Korea is in conciliatory mood, or the opposite? One theory, says Gary Samore, of the International Institute for Strategic Studies, is that North Korea may want to show that, contrary to previous bluster, it has not yet extracted bomb-useable plutonium from all the spent fuel-rods at its nuclear facility at Yongbyon—but would if pushed. Another theory that better fits its recent pattern of threats, says Mr Samore, is that North Korea may use the presence of Mr Hecker and others to show off the raw plutonium it has said it produced. If America buys into a freeze, the stuff can be monitored. But if America doesn't...

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Afghanistan's new constitution

A fillip for Kabul

Jan 8th 2004
From The Economist print edition

A welcome step

Reuters

Karzai the beneficiary

Get article background

IT ALL went according to plan. Hamid Karzai's plan, anyway. On January 4th, after several weeks of occasionally testy debate, 502 delegates from across the country approved a new constitution for Afghanistan. The country will be run by a strong president—Mr Karzai is the clear favourite to win the post in the elections due later this year—with two vice-presidents in tow. A parliament with upper and lower houses will have lesser powers.

In a country where achievements often have a nasty undertow, this was unequivocal good news. It was not true, as some argued, that the grand assembly, or *loya jirga*, had left the country more polarised. On the contrary, the airing of grievances, many of them ventilated by self-serving warlords and crooks, was followed by the making of compromises and a patriotic appeal to unity.

The losers were those who had to lose if Afghanistan is ever to recover from 23 years of war. Burhanuddin Rabbani was one such. The little-loved former president, who has interests along the porous border with neighbouring Tajikistan, had hoped to elevate himself on a conservative platform at Mr Karzai's expense: he was sidelined. So were the neo-Taliban insurgents. They had threatened to kill delegates to the *loya jirga* but now look weaker for their failure to do so.

Some human-rights groups worry that too much ground has been given to religious fundamentalists. The constitution defines Afghanistan as an Islamic republic, and says that no laws can be passed that are “contrary to the beliefs and practices of Islam”, a provision that may be exploited in the future by Islamic populists. Other compromises however, should strengthen the country. In particular, the last-minute inclusion of Turkmen and Uzbek as officially recognised languages in areas where they are spoken by a majority will help the government seem less of a Pushtun-Tajik affair and more like one that reflects the nation's diversity.

Enforcing the new constitution, however, will not be easy. The elections, for president this year and parliament next, will be murderously difficult to carry off, not least because of the paltry resources devoted to voter registration. The country's security problems were underlined this week by a bombing in Kandahar. Some delegates may have co-operated with the *loya jirga* onlyto distract attention from their drug-producing enterprises. Besides, a strong presidency presumes a competence in Mr Karzai, or another candidate, not to mention the Afghan civil service, that is far from proven.

It would be churlish though, to overlook the obvious: for the first time in a generation, Afghans of all stripes saw their interests better served in backing Kabul than in undermining it. It's a start.

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China

Muscle for hire

Jan 8th 2004 | SHENZHEN
From The Economist print edition

Another western fad reaches China

LI JICHENG is a squat and muscular former martial-arts instructor in China's special forces. He talks with relish about what he says is a promising market: a burgeoning demand for bodyguards among people wanting to protect themselves from business rivals, gangsters, thieves, ex-spouses and other threats to their safety. But although Mr Li says he has trained hundreds of people who now work as bodyguards, the government is still hesitant about giving its blessing to the country's fast-growing, though still semi-clandestine, personal-security industry.

In Shenzhen, a city bordering on Hong Kong, wealthy entrepreneurs now routinely hire bodyguards. Demand is also strong among Hong Kong and Taiwanese businesspeople who operate many of the factories in Shenzhen and other parts of Guangdong province. Although China is usually considered a relatively safe place for foreigners, there are pockets of lawlessness. Business and labour disputes often flare into violence. Taiwanese officials say more than 60 of the island's businessmen and their family members have been murdered on the mainland since 1991 and more than 50 have been kidnapped or unlawfully detained.

The government, ever reluctant to dilute the power of its security services, does not allow private firms to register themselves as bodyguard agencies. However Mr Li, who runs a martial-arts training centre in Shenzhen, says he is often approached by businesspeople looking for potential recruits. Desirable skills, he says, include unarmed combat, driving and firearms experience (the last through service with the police or armed forces). Although private citizens are not allowed to carry guns in China, there are frequent reports of armed crimes. In November, a Guangdong newspaper said that numerous illegal firearms had been discovered in Shenzhen in recent months.

Zhao Qihua, the general manager of a private trading and agricultural-products company in Shenzhen, says he hired two bodyguards in 2002 after thugs attacked workers on his firm's estate in the city's rural outskirts. He suspects a local official of having instigated the attack in an effort to force the company to surrender its valuable land. “I should protect my boss as best I can,” says one of the bodyguards, a 27-year-old martial-arts expert who is paid $1,200 a month for his services—a very high salary in China. Mr Zhao says the thugs have not dared reappear.

Some in Shenzhen's bodyguard industry believe that the government's attitude, at least in the more liberal south, is softening. In fact, Shenzhen already has dozens of private firms offering bodyguard services. They try to deflect official attention by choosing names for their companies that avoid explicit reference to their true function. But Zhang Hucheng, general manager of Wolfman Commercial Investigations and Security Consultancy, says his company advertises its bodyguards in local and Hong Kong newspapers, while the authorities turn a blind eye. Rules, after all, are made to be broken.

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Japan

A shrinking giant

Jan 8th 2004 | TOKYO
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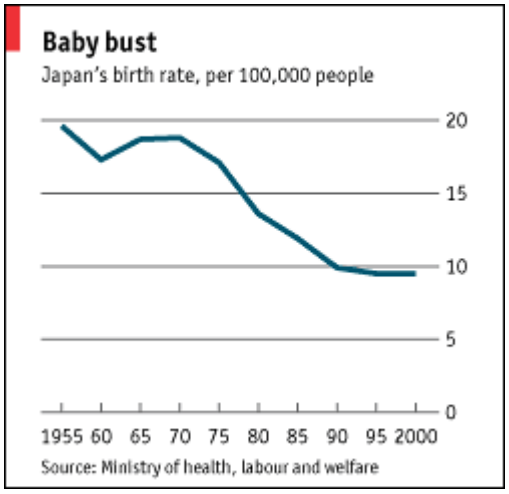
Can Japan revive its economy in time to cope with a dwindling workforce?



JAPAN is entering a crucial lap in its economic race against time. The good news is that, as it makes the turn into 2004, the economy is riding the momentum it built up during a moderate expansion last year. Real GDP grew by an estimated 2.6% in 2003, according to *The Economist*'s latest poll of forecasters, and is expected to rise by another 2% this year. The bad news, however, is that even though the economy has sped up for a bit, Japan's runaway demographic trends still threaten to leave it in the dust.

The population of 127m barely changed in 2003, rising by fewer than 100,000. The number of births continued its steady slide, with only 1.12m babies being born last year. Japan's 1.03m recorded deaths, meanwhile, were its highest number since 1947. Within only a year or two these two trends are expected to cross, and the population will begin to fall. The combination of a shrinking population and an increasingly elderly one will have a growing impact on everything from demand for goods and services, to public finances, to the structure of the workforce. Within five years, for example, Japan's universities expect to have more available university spaces than applicants.

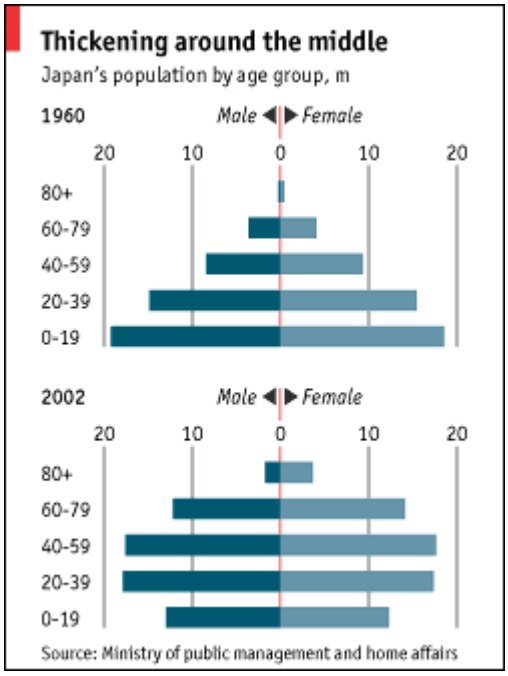
The effects of these trends on the workforce could be especially dramatic. Although the overall population is just beginning to peak, the number of people in their working years (between 15 and 64 years old) has been falling since 1995, when it reached 87m. The National Institute of Population and Social Security Research forecasts that this age group will shrink to 70m in 2030, and to as few as 54m in 2050. Meanwhile, the number of people aged 65 and over is expected to rise from less than one-fifth to one-third of the population. If Japan cannot find some way to slow this trend, or to mitigate it through new sources of labour or faster productivity growth, it will eventually take a heavy toll on the economy.

One way to bolster the workforce would be through immigration, a prospect many Japanese find unsettling. A report published this week by Robert Feldman, Morgan Stanley's chief economist in Tokyo, does not offer them much comfort. Mr Feldman reckons that, on current trends in demography and productivity, Japan will need to import 5m foreign workers over the next decade (not counting their dependants) just to maintain the current anaemic rate of improvement in living standards. “The numbers of required immigrants are so large”, wrote Mr Feldman, “that they recast the entire debate.”

Japan could also increase its workforce in other ways, such as by making it easier for women and the elderly to take productive jobs. Progress on this front, however, seems much too slow when compared with the speed at which the labour force is shrinking.

If labour reforms and productivity do not keep pace with the demographic challenge, one way in which living standards will suffer is through a squeeze on the social-security system: a daunting prospect in the land of the rising debt ratio. The ruling coalition worked out a compromise last month to raise premiums from 13.6% to 18.4% of employees' pay, while cutting benefits from 59% to 50% of average salaries, over the next decade-and-a-half. It is expected to introduce a bill along these lines in

February. Even these changes will not be enough to close the pensions gap without faster economic growth, which will become harder to achieve as tax burdens rise. Japan's reformists might want to pick up the pace.



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Israel

No through road

Jan 8th 2004 | JERUSALEM
From The Economist print edition

Getty Images

Might Ariel Sharon admit that his tough tactics towards Palestine won't work?

Get article background

SHIMON PERES, the leader of Israel's opposition Labour Party, says he has given up whatever hope he had of Ariel Sharon, the prime minister, bringing peace by withdrawing from the Palestinian territories conquered in 1967. But the Jewish settlers on those lands aren't so sure. They hope Mr Peres is right in thinking that the prime minister is too weak or too weary to turf them out of their homes. But if Mr Sharon does move against them, they say, they will fight him politically and bring his government down.

For Mr Sharon, such angry bluster from the right is welcome. It helps his effort to build an image as a moderate, statesman-like father of the nation. “They can wave their placards as much as they like,” he grandly assured the chairman of his Likud party's convention in Tel Aviv this week as jeering groups of right-wingers held aloft their protesting placards. “They can demonstrate, but it's my job to decide. And I will decide.”

His decision, Mr Sharon spelled out to the sea of raucous delegates, was to “disengage” from the Palestinians if they continued to balk at taking bilateral steps. He said that Israel was ready, subject to a string of reservations, to implement the American-backed “road map” to peace. But the Palestinian Authority had to start by disarming and dismantling the terrorist organisations. If that happened, he said to loud boos, “the government of Israel, under Likud leadership, will be prepared to do its part to make possible the establishment of an independent Palestinian state” with provisional borders. Failing that, Israel would act alone, separating itself from the Palestinians physically and politically. This, he said, as the booing and heckling hit a crescendo, would mean removing some of the settlements, though fewer, he implied, than in a negotiated accord.

Plainly, in Mr Sharon's mind, neither scenario would involve withdrawal from almost all of the West Bank and Gaza, which for Mr Peres and the Israeli left, as well as for the Palestinians, is the only way to peace. Rather, the prime minister envisages a shrunken territory on the West Bank, surrounded and encroached upon by the security fence now being built to embrace many of the settlements.

Not entirely new

Mr Sharon has given much of this disengagement speech before, most recently last month, when he said he would remove unauthorised settlement outposts that have sprung up in recent years. Under the terms

of the road map, Israel promised last summer to do so “immediately”, but nothing happened bar some desultory attempts by the army to evacuate a few tiny outposts, most of them reoccupied since.

Now Mr Sharon and his defence minister, Shaul Mofaz, have signed orders to dismantle six specific outposts; 22 more, out of an estimated 100-odd, appeared on a leaked defence-ministry list for early removal. But nothing has happened on the ground, making Mr Sharon's critics think that nothing will.

And yet there is a new air of expectation. Mr Sharon's press people insist he is determined to push his plan through. Though a peace deal with the Palestinians is unlikely any time soon, he says he wants to disengage and make the unspecified “painful concessions” promised since he took office three years ago.

Why might he mean it? Perhaps because he now senses that the Israeli public thinks his strong-arm tactics have failed. When four past chiefs of the Shin Bet security service declared in November that the present policy was leading Israel to disaster, the whole country caught its breath. After all, it was they who had been trying, for 20 years, to implement it.

One of the four, Ami Ayalon, has teamed up with a prominent Palestinian, Sari Nusseibeh, to produce a blueprint for peace that includes a full Israeli withdrawal. Tens of thousands of Israelis and Palestinians have put their signatures to the document. Meanwhile Yossi Beilin, a former Labour minister, and Yasser Abed Rabbo, a former minister in the Palestinian Authority, has signed a similar agreement, known as the Geneva accord, after two years of dogged negotiation. This, too, envisages a Palestinian state in virtually all of the West Bank and Gaza, with some land swaps to accommodate large settlement blocks near the 1967 border. To Mr Sharon's chagrin, it has earned enthusiastic accolades abroad, plus, even more troubling for him, a lot of support among Israelis.

In August, Avraham Burg, a leading Labour man who was chairman of the World Zionist Organisation, published an article, noticed worldwide, giving warning that the occupation was undermining Zionism itself. A month later a group of air-force pilots and navigators shocked Israelis by saying they would refuse to carry out attacks over the Palestinian territories. Their dismissal did not deter a dozen reservists in Israel's foremost special-forces unit from joining the refuseniks.

In any event, demography bears an apocalyptic message. The left has long cited the Palestinians' surging birth rate as reason enough for the Palestinians to be given a state before Israel, in its expanded territory, is engulfed by them or hardens into an apartheid state.

Mr Sharon's deputy prime minister and close ally, Ehud Olmert, has begun to acknowledge such fears. To deflect the demographic threat, he says that Israel must divest itself of much of the territories, unilaterally if need be.

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Iran's diplomacy

Getting nicer

Jan 8th 2004 | TEHRAN
From The Economist print edition

Could Iran ever realign itself to become a force for regional moderation?

Get article background

FOLLOWING the quake that levelled Iran's south-eastern town of Bam two weeks ago, it would have taken another seismic shift for Iran to accept the high-level delegation that President George Bush proposed to send to his stricken foe. On January 3rd came Iran's response: not now, maybe later. Too warm a welcome from normal Iranians would have belied the official Iranian fallacy: that the people loathe the “Great Satan”.

AP

Satanic charity for the survivors in Bam

The Americans are keeping open their offer to dispatch a senator and an unidentified member of the Bush family. And Iran has until April to enjoy less hazardous fruits of American compassion: a three-month lifting of various economic sanctions, including the ban on sending American funds to Iran. This “90-day opportunity” has stirred up much excitement.

An opportunity for what? The Americans say their measures are solely humanitarian. But Iran has long portrayed the lifting of sanctions as a precursor to the reopening of relations that were cut in 1979, when the late Ayatollah Khomeini came to power. On New Year's Day, Mr Bush listed three tasks that Iran must fulfil to win more favours: abandon its nuclear programme; extradite the (roughly 350) suspected al-Qaeda members in its custody; and “listen to the voices of those who long for freedom”.

On the nuclear issue, Iran has already climbed down. Prevented by international pressure from getting the technology to build a bomb, Iran seems to have put its programme into cold storage. That impression will need endorsing by UN monitors before America stops menacing Iran with the prospect of referral to the UN's Security Council. But the Americans sound cautiously optimistic that the Iranians' nuclear disavowal is genuine.

Whether or not they entered the country with the connivance of Iran's militant Revolutionary Guards, the al-Qaeda detainees have become an embarrassment to their hosts. Some big fish, including the organisation's number three, may be among them. If they are deported to their home countries, such as Saudi Arabia, Iran fears it will face reprisals by al-Qaeda.

Last month, America ruled out an obvious quid pro quo by vetoing a decision by Iraq's American-

appointed Governing Council to hand over 3,800 members of the People's Mujahideen, an Iranian opposition group that had been based in Iraq, to the Iranian authorities. Many may now get asylum in third countries.

Iran is making diplomatic waves elsewhere. It is on the verge of restoring full relations with Egypt. This week the Tehran municipality changed the name of a street called after the assassin of Egypt's Anwar Sadat, the first Arab leader to make a formal peace with Israel. Some dissident Egyptians in Iran may also be extradited.

Ali Tajerniya, a member of the Iranian parliament's foreign-affairs committee, senses a coming “strategic realignment”. By steadily improving relations with Turkey and hobnobbing with Jordan's King Abdullah, Iran's rulers seem to be quietly ending its castigation of Muslim countries that do business with Israel. On that score, says Mr Tajerniya, Syria stands to lose. Iran's indispensable ally when both countries were threatened by Saddam Hussein's Iraq, Syria is now squirming under American scrutiny (see article).

Iran's new pragmatism has been forced upon it by the pressure that has built up since Mr Bush included it in his “axis of evil”. Progress would be quicker were it not for the poisonous rivalry between President Muhammad Khatami's reform-minded government and the conservative clerics gathered around the “supreme leader”, Ayatollah Ali Khamenei.

After his election in 1997, Mr Khatami tried to bring Iran closer to the Americans. Invoking revolutionary ideology, powerful conservatives stymied his effort. The conservatives' rhetoric remains unpleasant, with one of their newspapers calling Mr Bush's partial lifting of sanctions a “deceitful” gesture. But conservatives may well make further concessions simply to keep themselves off Mr Bush's hit-list.

It was the clerical establishment, after all, that guided Iran's nuclear climb-down, despite vetoing Mr Khatami's earlier efforts to make concessions. The same is true of the rapprochement with Egypt. “The reformists are upset”, says one conservative, “that we can do things that they cannot.”

Only on Mr Bush's third demand, that Iran become more pluralistic, are the conservatives likely to demur. They plan to use their unaccountable powers to ensure that when Mr Khatami, a genuine democrat, steps down next year, his place is taken by a pragmatic conservative. Their model is another semi-dictatorship, Pakistan, where an alliance with the United States has been based not on shared ideals but on old-fashioned realpolitik.

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Syria

So lonely

Jan 8th 2004
From The Economist print edition

Why Syria's president, Bashar Assad, is in such a bind

Get article background

PITY Bashar Assad. A modest eye doctor, he did not wish to succeed his father, Hafez, but his big brother's death in a car crash changed all that. He would rather have inherited a quiet, rich country, not a poor weakling bordered by such enemies as Israel, which sits in taunting occupation of a mountain-top that can be seen from his palace windows on a clear day. He would prefer not to rely on people deemed by much of the world to be scoundrels, but then Iran, along with Hamas and Hizbullah, two Islamist groups that fight Israel from within the occupied territories and from Lebanon respectively, are among Syria's few remaining friends.

At home, greedy relations and his late father's suspicious cronies have stymied Mr Assad's efforts at reform. Attempts to break out of isolation have fared little better. True, he is the first Syrian leader ever to have crossed the country's longest border to visit neighbouring Turkey. But that is a smallish triumph. Last month, Syria was set to clinch a free-trade deal with the European Union, but a requirement to disavow poison weapons may now block it—rather like the breakthrough in long-troubled relations with America when Syria offered intelligence on al-Qaeda, only to be reversed when America was so angered by Syria cheering Iraq's “resistance” that it passed the Syria Accountability Act presaging even wider anti-Syrian sanctions.

Bad luck, too, that Iran and Libya have just decided to bin plans to develop nasty weapons. This makes Syria's own chemical-tipped rockets stand out, though Syria is still, technically, at war with nuclear-armed Israel.

Mr Assad says, reasonably, that he would happily give up his arsenal if all his neighbours did the same. But though even the Americans would like to see Israel some day dump its nukes, their priority is to disarm governments that are not very stable, and possibly prone to takeover by extremists who might actually use mass-killing weapons. That sounds more like Syria than Israel.

The most bitter pill yet may be Israel's early responses to Mr Assad's recent offer to resume peace talks. First, Israel's foreign minister said that if Syria met a set of preconditions, he just might agree to talks. Another Israeli minister then heralded an expansion of Jewish settlement on Syria's Israeli-occupied Golan Heights, so threatening to wreck any chance of a deal. Before Ariel Sharon, the prime minister, could tell everyone to be quiet, Binyamin Netanyahu, his finance minister, said that since America had defeated Iraq, Israel no longer had to make any concessions to the “isolated backwater” that Syria now is. Which is why Syria opposed America's invasion of Iraq in the first place.

But this week Mr Sharon's closest colleagues, including Mr Netanyahu, began sounding a lot more interested. Mr Assad is waiting for the call, nervously.

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Iraq's Sunni Arabs

Seeking a voice

Jan 8th 2004 | BAGHDAD
From The Economist print edition

It will be hard for Iraq's Sunni Arabs to find strong but peaceful representation

SINCE the American conquest eight months ago, Iraq's Sunni Arabs and Kurds have watched with growing alarm as the Shias' Grand Ayatollah Ali Sistani has extended his influence over the shaping of a new country. As he issues declarations from his home in Najaf, the Shias' holiest city, from which he has not set foot in over a decade, both the ruling American-led Coalition Provisional Authority (CPA) and America's Iraqi appointees on the Governing Council scramble to readjust their plans. Meanwhile Iraq's Sunni Arabs, who make up 15-20% of the population but had run the show since the country was founded, are floundering in their efforts to find a voice that the Americans as well as other Iraqis can heed.

Up in the north, the Kurds are showing signs of impatience with the new order—and are starting to follow Mr Sistani's example. Most Iraqi factions have at least paid lip-service to the Kurds' demand for federalism but have refused to spell out what that might mean. For some, it simply means that each of Iraq's 18 provinces would have a little more power than is usual in the Arab world. But for the Kurds it means that their northern slice of the country, historic Kurdistan, must have a special status. For months their representatives in the Governing Council have been trying, apparently in vain, to persuade their Arab colleagues to allow this.

With closed-door negotiations stuck, the Kurds have decided to go public. The newspaper of the Kurdistan Democratic Party recently published an article by its leader, Massoud Barzani, rejecting an 18-province solution while stressing that the Kurds, having enjoyed 12 years of de facto independence in the north, would not accept anything less than a federal region of Kurdistan. He further implied that this region must include Kirkuk, an oil-rich city also claimed by Arabs and Iraq's Turkomen minority, who are ethnically close to the Turks who ruled what is now Iraq until the end of the first world war. Mr Barzani said that if other Iraqis stand in their way, the Kurds might “resort to other choices”—a threat, presumably, to secede.

Most Turkomen leaders say they have no desire to live in a Kurdistan, federal or otherwise. In any event, the Kurds' political offensive touched off two days of ethnic fighting in the new year; at least six people were killed. On January 4th, the CPA conceded that the Kurds would continue to enjoy their autonomy in their northern self-rule zone even after power is devolved in July to a sovereign Iraqi government. This concession shows America's reluctance to antagonise the Kurds.

But Iraq's Sunni Arabs are also looking for political clout. Until recently, their main way to get the CPA's attention has been force. After a short lull, insurgents have stepped up their attacks.

We don't just kill people

The Sunnis' most prominent above-ground organisation is the Muslim Scholars' Board, a clutch of theologians and preachers who came together after the war because its members did not believe that CPA-appointed officials could legitimately rule on religious matters. Though the board's decisions are

widely accepted, its members' often bellicose declarations make the Americans reluctant to treat it as a voice of the Sunnis. For instance, one of the board's top members, Mohammed Bashar al-Faydhi, recently said he hoped that the anti-American insurgency would spread from the “Sunni triangle” to encompass “Iraq's entire quadrangle”.

Some Sunnis argue that unless they present a more moderate face the CPA will leave them at the mercy of the Shias. These Sunnis claim that they are the majority in Iraq and that Sunni Arabs deserve more than the five seats that they were allocated in the 25-member Governing Council. But they argue that, if their co-religionists go on expressing themselves through violence, they will be playing into their enemies' hands.

The Muslim Brothers, the Iraqi wing of the 80-year old Sunni movement that has branches across the Arab world, have been trying to create a Sunni umbrella movement to embrace Kurds and Turkomen as well as Arabs. An offshoot of the Brothers, the Iraqi Islamist Party, already has a member on the Governing Council; the movement hopes to have more prominent Sunni religious figures in any future interim government.

Recently the Brothers have met representatives of the Sunnis' conservative Salafi movement and a handful of Sufi mystics at Baghdad's Um al-Qura mosque to form a State Sunni Council. Despite the militant symbolism of the setting, known in Mr Hussein's time as the Mother-of-All-Battles mosque, the meeting's message was pragmatic. Some of the new council's members say they should work out how to co-operate with the CPA. But others are more bluntly sectarian. “Sunnis have ruled Iraq since it was created,” says one member's aide. By letting the Shias dominate, the CPA, he says, is playing into the hands of “Iranian imperialism”.

On January 1st, American troops and Iraqi paramilitaries raided Baghdad's main Salafi mosque and arrested its prayer leader, Sheikh Mahdi al-Sumayda. The Americans said the mosque was a staging-post for the insurgents and that weapons confiscated included mortars and an anti-aircraft missile. The next day Sunni worshippers marched through the streets chanting that “America is the enemy of God.” Clearly, improving relations between Iraq's Sunni Arabs and the Americans will not be easy.

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Sudan

War and peace

Jan 8th 2004 | NYALA
From The Economist print edition

Just as one war is ending, another threatens to replace it

Get article background

AFRICA'S oldest civil war, which has blazed on and off for half a century, inched closer to extinction this week. By agreeing on a formula for sharing the country's oil wealth, Sudan's government and its main rebel opposition, the Sudan People's Liberation Army (SPLA), took a crucial step towards a formal peace pact and the establishment of a government of national unity.

The war began because the people of southern Sudan, who are mostly black and either Christians or believers in traditional African gods, detest the government in Khartoum, the capital, which is dominated by Arab Muslims, a minority with a long history of enslaving their compatriots. But now, after 2m deaths, both sides are exhausted and sick of fighting.

Under pressure from America, whose threats are taken seriously these days, peace talks that started in 2002 are progressing steadily. Sudan's Islamist regime now says it is prepared to share power, to allow more freedom of religion, and to let the south hold a referendum on secession in six years' time. This week, some of the practical details of how wealth is to be shared were unveiled. There is to be a presidential commission to oversee the fair division of the cash, and two banking systems: a conventional one in the south, and an Islamic one in the north, which will be barred from charging interest.

Disagreements persist, notably over how exactly power is to be shared, and who is to control three northern areas that fought alongside the SPLA. But the biggest worry is a new, separate and barely reported war in the north-western region of Darfur. Since it flared up in February last year, around 700,000 peasants have been forced to flee the embers of their homes. Media access to the region is tightly controlled, but your correspondent found scenes at least as miserable as those once common in the south.

Outside the town of Nyala in southern Darfur, for example, 7,000 fugitives have made homes of leaves, sticks, plastic bags and bits of cloth. The government says it cannot dig them latrines on land designated for proper homes, so the fly-infested camp gets dirtier by the day.

This new war has many causes. Farmers in Darfur have long feuded with nomads over land, water and grazing rights. Desertification, population growth and decades of official neglect have made the feuds more intense. Last year two rebel groups promised to fight for farmers' “political and economic rights”.

The government reacted with the same brutal tactics it has used in the south, arming a hotch-potch of Arab nomads, hangers-on and criminals, ordering them to “defend” themselves, and giving them carte blanche to shoot, loot, burn alive and rape. The regular army has helped out with intelligence and uniforms, by dropping bombs on areas suspected of supporting the rebels, and by making it hard for aid workers to reach the area.

Militia mania

A ceasefire was agreed on in September, but the mounted *Janjaweed* militias ignored it. One fugitive near Nyala describes how they came and burned his village, killing some 56 people, and were then supported by government helicopters. A woman in the same camp says the marauders killed 35 people in her village, including her husband. Hundreds of villages have been destroyed. With people unable to work their fields, and still reeling from a drought in 2001, famine beckons.

The government denies controlling the militias. The minister of information talks of an unruly “local conflict” resulting from the proliferation of small arms in the region. Junior army officers have been sent to peace talks across the border in Chad with one of the rebel groups, the secular Sudan Liberation Army (SLA), but these talks, and the ceasefire, have broken down.

The prospect of peace between north and south may be aggravating the conflict in Darfur: locals fear that the government and the SPLA will divide the power and oil money between them, leaving everyone else as poor as they were before. Perhaps because it feels it has enough on its plate already, or because it thinks it can get away with it, the government has so far done little to put such fears to rest.

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Muslims and the polio vaccine

Paralysed by fear

Jan 8th 2004 | KANO
From The Economist print edition

Religious scaremongering cripples

TEN-year-old Suleiman Abdulmalik hobbles though traffic on all fours, begging for crumpled notes. Polio, the virus that crippled him, has nearly been eradicated from the world, but not quite. A few pockets of infection remain, the largest of which is in northern Nigeria, where Suleiman lives. To send polio the way of smallpox, the World Health Organisation (WHO) needs to vaccinate so many people that the virus has nowhere left to hide. But the campaign has been hamstrung by scaremongering zealots.

Some Nigerian Muslims believe that the polio vaccine is part of an American plot to depopulate poor countries. Some imams preach that it is laced with anti-fertility drugs, can cause AIDS and is even linked to mad-cow disease. The source of these interesting theories was apparently American websites promoting “holistic” medicine.

Last October, three of Nigeria's state governments called off vaccination drives. Politicians have to take the radicals seriously. The previous governor of Kano state, for example, was voted out of office last April after warning that no cleric could tell him what to do, “no matter how long his beard is”.

Though his successor, Ibrahim Shekarau, is thought to believe in vaccination, he has suspended polio vaccinations in Kano and set up a committee of medical doctors and Muslim scholars to oversee testing of the vaccine in a state-run hospital. The committee was expected to calm popular fears. It didn't. On January 2nd, its chairman gave the vaccine the thumbs-down on the ground that tests had revealed traces of oestrogen, a female hormone that could affect fertility.

Tests elsewhere have found no such contaminants, and experts insist the vaccine is safe. But hardline imams are now calling for a boycott of all western drugs, including aspirin.

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France

Jean-Pierre and Jacques go up the hill

Jan 8th 2004 | PARIS
From The Economist print edition

Reuters

Despite a recent popularity boost, Jean-Pierre Raffarin remains vulnerable as Jacques Chirac's prime minister

Get article background

AFTER suffering a collapse in confidence last autumn, the French government's spin machine has gone into overdrive. This year, declared President Jacques Chirac on January 5th, would be one of “action” and “results”. Jean-Pierre Raffarin, his prime minister, promised that he had “the will to reform” and “determination” to press ahead. “One thing is sure,” he told *Sud-Ouest*, a regional newspaper. “I have confidence in the future of France.”

But does France have confidence in him? The man who began 2003 with a high approval rating of 58%, according to TNS Sofres, a pollster, saw that figure crumble to only 29% by December. The fall accelerated after last summer's heatwave, in which 15,000 people died while most of the government seemed to be on holiday. By December, speculation was swirling that his time as prime minister was up.

There was no repeat of the summer's complacency this weekend, after a plane crash in the Red Sea in which 133 French passengers died. Mr Raffarin promptly summoned television reporters to express his sorrow; ministers were despatched with wreaths to the crash site. Other elements are also falling into place. The economy seems to have taken a slight upturn in the latest two quarters. There have been harsh but successful attempts to clamp down on smoking, crime and motorway speeding. A proposed ban on the Muslim headscarf in state schools has already proved popular. Mr Chirac warmly backed his prime minister in his new year's greetings. A relieved Mr Raffarin leapt seven points in a *Paris-Match* poll this week.

If Mr Raffarin has secured his job for the time being, however, that is no guarantee that he will last out his full term—or even the rest of the year. Much will depend on three unknowns. The first is elections, to the country's 22 regional governments in March and to the European Parliament in June. Despite Mr Raffarin's attempts to play down the national significance of the regional elections, they will give French voters their first chance to judge the government since 2002.

The threat to the right-wing majority comes not from the Socialist Party, which remains both leaderless and in utter disarray, but from the political extremes of far left and far right. If, despite the government's

efforts to tighten up on illegal immigration and crime, the far-right National Front does well or even grabs control of a region—as looks possible in Provence-Alpes-Côte d'Azur—the government will take a knock and Mr Raffarin will be vulnerable once more.

The question of who might replace him bumps into the second unknown: the effects of personal rivalries. Late last year, ministers seemed to be competing to leak and claim credit for good news, behind the prime minister's back and to the irritation of the president. The trouble is that the boldest of all happens to be the government's main asset: Nicolas Sarkozy, the preternaturally energetic interior minister, who is as popular among French voters as he is outspokenly critical of his colleagues.

Mr Sarkozy, who does not disguise his own presidential ambitions, has suggested that no French president should serve more than two terms (Mr Chirac, conveniently, is already into his second). This week, the minister was again busy riling the president, by advocating “positive discrimination”, a French taboo that Mr Chirac has ruled out. But the French seem to love him—or, at any rate, they warm to his equally uncompromising anti-crime and anti-illegal-immigration views.

Could Mr Sarkozy make a useful prime minister, to restore the government's popularity? There is a snag: Mr Chirac distrusts the man and has never forgiven him for his support for a rival presidential candidate, Edouard Balladur, in 1995. In a thinly disguised warning to his interior minister, the president this week told all his ministers to form a “united team”.

A more intriguing possibility is that Mr Chirac may keep Mr Raffarin in place even if the right suffers an electoral setback. But, in a bid to counter Mr Sarkozy, he might also restore to the government his most loyal chum: Alain Juppé, who was an unloved prime minister during Mr Chirac's first presidency. Mr Juppé, now head of the ruling Union for a Popular Movement party, remains a frequent sounding-board for Mr Chirac. The president turned the opening of a tramway in Bordeaux into an affair of state by dropping in for a ride: Mr Juppé is the local mayor. He is also awaiting a verdict on January 30th in a corruption trial relating to his time at the Paris town hall when Mr Chirac was mayor. If he is acquitted, he could come back, not as prime minister (too unpopular), but perhaps as finance or even foreign minister.

Whether Mr Raffarin stays the year, however, depends most heavily of all on the third unknown: his ability to push through reforms. During this week's new-year toasts, Mr Raffarin listed many plans, ranging from schools to decentralisation. The most pressing cover health care and the labour market. A “diagnostic” report on the health problem—essentially, more older and sicker people, more expensive treatment and a deficit for the public-insurance system—is due by the end of January, and proposed reforms by July.

On the labour market, some changes are already in place. The cut-off period for long-term unemployment benefit for those under 50 was trimmed on January 1st from three years to two. Further proposals, designed to get the unemployed back to work and stimulate job creation and investment, are due soon. Many are quite liberal: one would lengthen short-term contracts, enabling companies to hire more staff without risking big lay-off costs.

All of this will run into fierce resistance: from doctors, pharmacists, pill-popping patients, the unemployed, unions and so on. And it comes at a time when the economy is still shaky. Unemployment remains high (9.6% overall, and 21% for those under 25). Even with the recent upturn, growth is expected to reach at best 1.7% this year: exports are suffering from the strong euro and domestic demand is weak.

Mr Raffarin may sound again like the confident man who faced down public-sector workers over pension reform last year. He may have won a second chance after the heatwave blunders. But, in a delicate election year and with such fickle public backing, any further bumbling or failure will not be forgiven.

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Georgia's new president

The people expect

Jan 8th 2004 | TBILISI
From The Economist print edition

Mikhail Saakashvili will find it hard to meet Georgians' expectations

Get article background

HARDLY anybody bothered to campaign; the opposition candidates were straw men; the turnout was huge; and the winner took over 96% of the vote. Georgia's presidential election sounds at first blush a bit like the old Iraq. But in this case international observers and voters alike were delighted that Mikhail Saakashvili, a 36-year-old American-educated lawyer, won by a landslide. He has won admiration at home and abroad for leading the “rose revolution” that forced Edward Shevardnadze, Georgia's leader for most of the past three decades, to step down.

Yet ousting a discredited president may prove easy compared with the job of hauling this potentially rich country out of its morass. The expectations of a bitterly frustrated nation have been invested in the flamboyant (and impressively multilingual) Mr Saakashvili. Can he deliver?

AP

Georgia, a fertile and strategically located ex-Soviet republic, has come close to collapse in the past 12 years. Wars over the near-secession of two provinces, Abkhazia and South Ossetia, have created 300,000 refugees. Factories lie abandoned. With $1.78 billion in foreign debt, the government is barely able to pay for its Russian energy imports. Massive corruption and tax avoidance led the IMF to suspend lending last summer. Only some $2.5 billion in American and European aid have kept the country going.

Since he gave up a promising career at a New York law firm, Mr Saakashvili has cast himself as a man of the people and scourge of Georgia's post-Soviet elite. Critics retort that he is a populist with a dangerous habit of speaking before he thinks. But on corruption, at least, he seems serious. He won a reputation for zeal during a brief, stormy period as Mr Shevardnadze's justice minister. Already the new government has begun questioning ex-officials, including a former energy minister accused of pilfering state funds. Mr Saakashvili is bullish too about resolving the decade-long conflicts with Abkhazia and South Ossetia. He promises to lure the rebel provinces back with the carrot of a more prosperous, stable Georgia.

Yet Ghia Nodia, director of the Caucasus Institute for Peace and Democracy, predicts that the new president will find the reality of government hard. On corruption, for instance, “he can't take on everyone at the same time. He'll have to compromise over whom to take on.” He must also cut deals with key partners: Nino Burdzhanadze, who wants to be parliamentary speaker, and Zurab Zhvania, who may take a new post of prime minister. All three are young and power-hungry. “There's all sorts of potential for division,” comments one western diplomat.

Mr Saakashvili's pledge to deepen relations with the United States, but at the same time repair strained ties with Russia, will be no easier to deliver. As a crucial link in a planned pipeline to carry Caspian oil westwards, Georgia has powerful friends in Washington who helped to propel Mr Saakashvili to the presidency. American troops are training the Georgian army; the American ambassador, Richard Miles, has become a familiar face in politics.

But Russia, which has been comprehensively outmanoeuvred by the Americans, is determined not to lose further ground. It is still the biggest market for Georgian exports, as well as having a near-monopoly on energy supplies. The Russians continue to drag their feet over removing two Soviet-era military bases

from the country; Russian “peacekeepers” are stationed in South Ossetia and Abkhazia. Moscow claims, with little evidence, that Chechen rebels still operate from Georgia's Pankisi gorge. And it has infuriated Tbilisi by offering residents of another restive region, Ajaria, visa-free travel, while insisting on visas for the rest of Georgia.

The most recent Georgian leader to enjoy the adulation that now surrounds Mr Saakashvili was Zviad Gamsakhurdia, a fiery but eccentric nationalist who led the country to independence. But his tenure ended with gun battles in Tbilisi. That is a sobering thought for the new president. He might also consider the fate of the man he overthrew. Not long ago Mr Shevardnadze inspired hope, enjoyed high esteem in the West and was a mentor to young reformers like Mr Saakashvili. The window of political opportunity may be even smaller now. “The people have woken,” said one man leaving a polling station in Tbilisi. “And from now, we won't forgive our leaders their mistakes.”

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German universities

Lower education

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From The Economist print edition

The budget problems of German universities stir much-needed debate

AP

The bare necessities of student life

TOURISTS visiting Berlin have been treated to some strange sights recently: students raking up leaves, running naked through Christmas fairs, or holding seminars under the Brandenburg Gate. Similar media-savvy protests against budget cuts were staged in Frankfurt, Göttingen and Munich. The protests have triggered a debate about universities that is unlikely to abate soon. On January 6th Chancellor Gerhard Schröder and his Social Democrats launched an "innovation offensive", which included efforts to boost higher education. In a manifesto, they even called for the creation of German equivalents to America's Harvard or Stanford, usually anathema for an anti-elite party.

Even more than in other European countries such as France, Italy and Spain, where universities are also failing to deliver, there is a disconnect in Germany between the lip-service paid to higher education and the reality of its academic institutions. In this land of philosophy, *Bildung* is treated as a value that should be free for all. But universities are the first to suffer budget cuts. Lecture halls are overcrowded (to get a seat for a 9 o'clock seminar, you must show up at 6), professors unmotivated, and degrees obsolete—true higher education often starts on the first job.

Things have been getting worse. Student numbers are going up, partly because of high unemployment. In the current term, over 2m were enrolled in the universities, the most ever. And the number will rise: only about a third of 19-to-24-year-old Germans attend university, half the share in Sweden and Finland.

The cost-cutting knife has also hit bone. In Berlin, the regional government has told the city's three universities to cut their budgets by €75m ($85m) a year by 2009. That will mean shedding another 250 academics, after having cut the number by half, to 1,100, in the past decade. There will then be 125 students per don, more than twice today's national average. Other state governments are imposing similar cuts.

Unsurprisingly, German academics are up in arms. "A country which is cutting its educational institutions into cripples loses flexibility and the power to innovate—and is thus squandering its future," thundered Wolf Lepenies, a noted German sociology professor. As for students, they either study abroad, often in America or Britain, or they take to the streets. Yet they shy away from any alternative solutions, such as tuition fees.

In this egalitarian society, tuition fees have always been a taboo. As recently as last year, the federal government changed a law to stop states charging for undergraduate studies. But the consensus is crumbling. Some states already plan to charge those students who never seem able to graduate. Some Social Democrats also favour tuition fees, financed by loans that are paid back only once graduates have big enough salaries. Berlin's government has proposed a novel sort of currency: students would get an account with 360 free "credits" each, enough for a normal diploma, but they would have to buy any extra credits they need.

Such models might solve some financial problems. But more far-reaching reforms are sorely needed. Central control of higher education stops universities from competing for the best students, professors and donors. Some say that academics should no longer be civil servants who cannot be fired, but employees paid by performance. In short, universities should be run more like companies. It is through competition among them that elite institutions would be most likely to emerge.

Unfortunately, Germany does not seem ready for such radical ideas. Yet if it, like the rest of Europe, wants to regain a competitive edge, better universities may be essential. Tackling health care, social security and labour markets, as Germany and France are belatedly doing, may be necessary—but it will not be sufficient.

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Spain's water wars

Ebro eddies

Jan 8th 2004 | MADRID
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A continuing row about diverting the River Ebro

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"I WILL not send a single drop of water from the Ebro," said Pasquall Maragall, the local Socialist leader, before November's Catalan elections. Now that he is head of the coalition government of Catalonia, Mr Maragall hopes to "paralyse" the Spanish government's plan to move water from north to south. The national hydrological plan, Europe's biggest water project, is set to be a big bone of contention in the long tussle between Madrid and Barcelona. The government of José María Aznar is pressing on: Mr Aznar's chosen successor, Mariano Rajoy, has condemned Mr Maragall's stance as "unpatriotic".

Last month the Spanish government formally requested European Union finance to meet a third of the $15 billion cost of the whole project. It claimed a victory when the European Commission conditionally approved €80m ($100m) to pay for a part of it, the transfer of water from Júcar to Vinalopó in the south. Mr Aznar has called the plan "an act of solidarity" between Spain's regions. In the run-up to March's national election, water has become a big political issue.

The water balance between the wet north, where a third of Spain's rain falls, and the dry south, where 60% of the land is semi-arid, continues to inflame passions. The national hydrological plan, first proposed by the Socialist government in 1993, envisages 120 dams and 1,000km of pipelines. It would divert a cubic kilometre every year away from the Ebro, of which a fifth would flow to the Barcelona area and the rest to Valencia, Murcia and eastern Andalusia.

Critics say the entire plan is outmoded, unwieldy and designed to benefit the government's business friends. They claim it will cost twice as much to transport the water as it would to produce more water through desalination. Asit Biswas, an international consultant recruited by the anti lobby, says it will be "a magnificent monument to bad planning for decades and even centuries to come". Greens also say it will destroy the Ebro delta wetlands, home to such protected species as spoonbills and egrets. The government of Aragon, through which the Ebro mostly runs, supports the Catalans, calling the project a "method to rob the poor to feed the rich". An EU that purports to believe in the power of regions may be cautious about being sucked in.

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Lithuania

Muddling on

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From The Economist print edition

The damage done by a president who refuses to go

YOU could hardly call Lithuania a banana republic: it is now shivering under thick snow. But the longer its president, Rolandas Paksas, clings on, the worse for the country's political reputation. As they prepare to join both the European Union and NATO, Lithuanians deserve better.

A parliamentary inquiry has found that Mr Paksas, a former prime minister, was surrounded by advisers linked to influence-peddling and organised crime when he took office a year ago. Last month parliament began impeachment proceedings, but these will be slow. A commission of parliamentarians and lawyers must produce a report that will then be reviewed by the constitutional court. A final vote could come “in March or April at best”, says one of those involved.

Until then Mr Paksas may tough it out, despite a global cold-shouldering that would dismay a less obstinate man. Lithuanian church leaders have called on him to go. The prime minister, Algirdas Brazauskas, who was president until 1998, says he would have quit in Mr Paksas's place. Foreign leaders have been dropping plans to visit Lithuania—or, as George Bush did last month, dissuading Mr Paksas from visiting them.

The main headaches for Mr Paksas relate to his ties with a Russian-born dealer in helicopter parts, Yuri Borisov, who bankrolled his election. According to the parliamentary inquiry, Mr Borisov was linked to a Russian lobbying firm probably tied to Russia's security services. His company may have traded with rogue states, including Sudan. He kicked in almost half a million dollars to get Mr Paksas elected, and made threats against Mr Paksas when he did not get a government job in return. Mr Paksas restored his Lithuanian citizenship, a move the constitutional court has since ruled illegal.

The parliamentary inquiry found also that Mr Paksas's security adviser, Remigijus Acas, was in contact with a lobbyist who was in turn in contact with people linked to organised crime, and who passed on confidential information to them and to businessmen. Mr Acas resigned in November, denying any wrongdoing.

One puzzle concerns the part played in all this by Russia. Lithuania was occupied by the Soviet Union until 1991, as were its Baltic neighbours, Latvia and Estonia, and Russia still covets all three. It tried to stop them joining NATO. Some Lithuanians see Mr Borisov as an agent of Russian influence, channelling money and know-how to help Mr Paksas oust his pro-American predecessor, Valdas Adamkus, from the presidency. Others think Mr Borisov backed Mr Paksas mainly to advance his own business interests.

A second puzzle is why Mr Paksas did not resign quietly in October, when the security services produced a first damning dossier against him. One answer might be that he had no competent advisers to tell him he was finished. Or Mr Paksas may be calculating that he is not, in fact, finished, even if the impeachment succeeds. And here, for better or worse, he could be right.

Under current law, even impeachment would not stop him running for the presidency in the election that his departure would provoke, nor from returning to parliament in elections due later this year. A tough populist, he has been travelling the country rallying supporters. He may still have the backing of one-quarter of voters. That would not be enough to win the presidency. But it could help his right-wing party, the Liberal Democrats, find a place in a future coalition, perhaps alongside another new and fast-rising populist party, the Labour Party.

And if the impeachment proceedings drag on too long, the anger at Mr Paksas might dissipate, allowing him to stay on. The EU and NATO need to brace themselves for that possibility. The countries joining

both clubs this year are democracies, certainly. But they are not all settled ones in which the usual rules apply.

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Swedish parental leave

Forced fatherhood

Jan 8th 2004 | STOCKHOLM
From The Economist print edition

How to encourage men to take more paternity leave

IT IS a common sight in Sweden: a single man trudging behind a pram while shopping or on his way to a nursery. “Papa leave”, the right of a father to take time off to care for his baby, is marking its 30th anniversary. Yet men take only a small fraction of their entitlement. They are under pressure to take more.

Scandinavia has long had generous parental leave. In Sweden, a couple can take up to 13 months off work between them, with the state paying 80% of lost wages up to a ceiling of SKr24,562 ($3,425) a month. A further 90 days can be taken for a token sum. The leave can be used in a block, or taken in batches before the child is eight. It is notionally divided 50-50 but, except for two months, it can be transferred between the parents. Other countries are less generous, though even Britain offers two weeks of paid paternity leave (the British industry secretary, Patricia Hewitt, recently suggested that fathers should be given six months' unpaid leave).

Yet many Swedish fathers are reluctant to use their “papa months”. Mothers take as much as 85% of all parental leave. This frustrates feminists, who believe that shared responsibility for child care is a key to equality in the labour market. Sweden has one of the world's highest rates of female participation in the labour force; but women's wages still lag men's, and only two out of 282 listed companies have female chief executives.

The government sympathises. It is impressed by evidence that fathers who take more responsibility for small children are more likely to stay in contact should the family break up. A commission is looking into ways to increase fathers' take-up of parental leave. Some, including Margareta Winberg, a former deputy prime minister, want to scrap the transfer of leave between partners. They say only such a drastic measure can force men to take their responsibilities.

Yet this suggestion is unpopular not just with fathers, but with many mothers. It has aroused cries of social engineering and interference in families' right to decide how to bring up their children. The government may prefer to offer incentives, such as a bonus to couples who divide their leave equally.

A recent survey by the National Social Insurance Board showed that most parents were satisfied with the present system. In today's climate, there is little scope to raise benefits. The most likely outcome will be an advertising campaign to make fathers more aware of their rights. As one slogan puts it: “How many men on their deathbeds say they spent too little time with their boss?”

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Charlemagne

Europe in a spin

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The mysteries of the European Union's rotating presidency

THIS week the start of Ireland's six-month presidency of the European Union was marked with a big jamboree in Dublin. That most citizens of Ireland, let alone of the wider EU, have little grasp of what this signifies says something about how hard it is for the Union to explain itself, both to ordinary Europeans and to the world at large.

Under the EU treaties each of the 15 member countries—to be 25 as of next May—takes it in turn to be "president" of the Union for a period of six months. This system of rotation was set up to ensure that everybody had a crack at managing the EU's internal agenda and at representing the Union to the outside world. But it can be a recipe for incoherence and confusion. Foreign leaders are treated to an endlessly changing cast of presidents, each of whom approaches the job with different priorities and personal styles. Silvio Berlusconi of Italy, who has just handed over to Bertie Ahern of Ireland, was personally thanked by Ariel Sharon for being the most pro-Israeli president of the EU for many years. But Mr Sharon's pleasure is likely to prove fleeting; the Irish are traditionally pro-Palestinian.

Naturally, the presidency is meant to reflect the consensus of opinion within the EU as a whole. But a president can launch policy initiatives, act as spokesman for the Union and draft the diplomatic statements that are issued at the end of each big European summit. That allows whoever is in the chair to put their own distinct spin on EU policies. If the president is a loose cannon like Mr Berlusconi there is no knowing what may suddenly appear to be "EU policy", if only for a few weeks. Mr Berlusconi appalled many by turning a recent EU-Russia summit into a love-in with Vladimir Putin, with almost no mention being made of democracy, human rights or Chechnya. In the run-up to the Iraq war, a rumour swept Brussels that the Greek presidency had launched a peace mission to Baghdad. To the relief of the permanent EU bureaucracy, it turned out not to be true. But it could easily have been. As it was, the Greeks did enough damage simply by calling an emergency summit on Iraq that served to showcase Europe's internal divisions.

The fact that as many as 17 countries in the new EU of 25 will be relative minnows, with populations of 10m or fewer, is likely to make this diplomatic mess even less acceptable to the big countries, notably Britain, France and Germany. There is already much rolling of eyeballs at the prospect of a Union of 450m people being represented by the prime minister of Malta, which has a population of just 383,000 (even less than Luxembourg). At times the bigger countries have looked to Javier Solana, the Union's indefatigable "high representative" for foreign policy, to impose some coherence on the EU's common foreign policy. But increasingly they are tempted instead to act on their own—either by blankly contradicting each other, as over Iraq, or by launching joint initiatives outside the framework of the Union. Late last year the foreign ministers of Britain, France and Germany staged a joint mission to Iran to make representations about that country's nuclear-weapons programme. There was no Mr Solana present, and no Mr Berlusconi either. The European "big three" were clearly rather happy with this way of doing business.

The "rotating presidency" does not work much better when it comes to internal Union business. The presidency can have a powerful effect on the laws that emerge from the Brussels machine, by putting items on the agenda (or, often more crucially, leaving them off it) and by shaping the final compromises. The presidency is meant to act as a neutral referee and not to promote national priorities. But few can resist exceeding their mandates. Fervent advocates of Europe's social model, such as France or Belgium, are often eager to promote social legislation. The British or Irish are more likely to stress economic liberalisation. Once a policy initiative is launched by a presidency, it is then up to the European Commission to propose ways of turning it into law. In most cases the European Parliament will be involved in amending any proposals. But the final shape of the law is usually decided by EU countries meeting in the Council of Ministers. Here the presidency can have a crucial influence by discerning

“consensus”, drafting compromises, or delaying discussion.

Infrastructure al Italiano

Italy's recent six months in the chair offer a fine example of how the presidency can affect the EU's policies. The Italians decided to put a huge amount of effort into promoting EU-funded infrastructure schemes. “The major goal of their presidency”, comments one European diplomat bitterly, “seemed to be to get the EU to fund a lot of bridges and tunnels in Italy.” And indeed, by the end of the presidency, an “action for growth plan” had been approved, heralding (at least in theory) a raft of new infrastructure projects across Europe.

The Italians also directed the ultimately fruitless negotiations on the draft European constitution. They had the sole power to put forward possible compromises, and could therefore exert a big influence on the outcome. At the final unsuccessful summit in Brussels last month, Mr Berlusconi appalled the French and Germans by announcing that there was a consensus to preserve national vetoes over tax and social-security policy, which had been the main demand of the British. A different president might have reached a different conclusion.

All these shenanigans provide endless amusement for diplomats and lobbyists. But they are hardly the stuff of which good policy is made. The draft EU constitution now languishing in the in-tray of the Irish presidency proposes the abolition of the rotating presidency and its replacement with a more stable and longer-lasting arrangement. That is a fine idea. But until the constitution is adopted, which may mean never, the presidency of the EU will keep rotating as surely as a pig on a spit. It will be a dizzying experience for all involved.

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The voluntary state

Hard at work

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The government wants volunteers to do more, but people are volunteering less

“COMMUNITY participation” sounds a wonderful way of making public services work better. Magistrates and special constables in the criminal justice system, school governors, lay members of police and health authorities, mentors for deprived children and struggling parents—all, in the government's view, make the state work better. The government's plans for reforming the health service require volunteers to sit on hospital boards. “Almost every public service has a citizen-engagement element,” says Richard Fries, a visiting fellow at the London School of Economics who studies charities.

The theory is fine, the practice difficult. There is no shortage of retired people with time on their hands, but it is increasingly hard to find the right kind of working-age volunteers. There are big shortages, especially in activities that demand large and regular commitments.

The causes are hotly debated. “Bowling Alone”, Robert Putnam's study of the decline in voluntary activity in America, blamed everything from television to commuting, as well as a general shift away from unselfish values established during the war. All of those may have had an effect; and it is certainly true that British employers are less keen for workers to take time off, even if it is for the public good.

There is, for instance, a worrying shortage of new lay magistrates, who must be able to spend at least 26 half-days a year trying minor crimes. There are no national figures; but in north-west London last year, only 57 of 80 vacancies were filled. Only 3.7% of the country's 28,344 magistrates are under 40, and more than a third are over 60. That trend means heavier reliance on stipendiary (paid) magistrates, and threatens to end a voluntary tradition dating back to 1195.

“We used to recruit heavily from the nationalised industries, and public services like health and education.” says Ann Flintham of the Magistrates' Association. “But teachers now no longer get permission easily and are told to keep to the school holidays. Health-service workers are expected to fit sittings around their existing shift patterns; in business, younger magistrates find that they risk being passed over for promotion.” There are similar problems in recruiting school governors—at nearly 350,000, the largest single group of volunteers in the country. It is easier to get parents than outsiders to give up the time. Around 11% of places for parent governors are vacant: for “community representatives” the figure is 19%.

Part of the problem is that the government is increasingly choosy. It wants ethnic-minority, disabled and working-class volunteers, especially in prominent positions, such as trustees. Charities tend to prefer people for these posts who are capable and rich. These categories do not necessarily chime.

Secondly, voluntary work is a lot more burdensome. Even members of humble parish councils, dealing with matters such as village playgrounds, must give a detailed disclosure of their private financial interests. Legal liability for injury to the public is a growing worry. Some kinds of volunteering require tiresome compulsory courses on health and safety or diversity. Anyone working with children needs to pass a criminal-records check.

One answer is to highlight the benefits, not the virtues, of volunteering. “We don't appeal to patriotism”, insists Tim Corry of SaBRE, which deals with military reservists' employment questions. It commissioned a study from Leeds University Business School, which purported to show that, per employee, employers get £9,000-worth of free training in team building, project management and suchlike from the Volunteer Reserve Forces.

Such arguments may convince the boardroom. But volunteering in company time may still fall foul of line

managers. Big firms that provide a lot of volunteers (Barclays and Nike are commonly cited) tend to make it part of employee development, backed by their human resources departments. “It's a lot better for morale to have people teaching kids to read for a couple of hours a week than sending them to shoot paintballs at each other,” says Jason Tanner of Community Service Volunteers, the country's largest umbrella group.

Another answer is to make volunteering less burdensome to both sides. The reservists typically take their time off in a two-week block once a year; that is more manageable than the magistrates' 26 irregularly scheduled court sittings. And there is growing interest in less demanding activities. “People increasingly want short-term, quick-hit volunteering because they've got busy lives,” says Mr Tanner. “They want to turn up, brighten up a school or clear some waste ground, and go away, and not feel that they are a bad person if they don't turn up next week.” That does nobody any harm; but it won't change the world.

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Sterling

Pounding ahead

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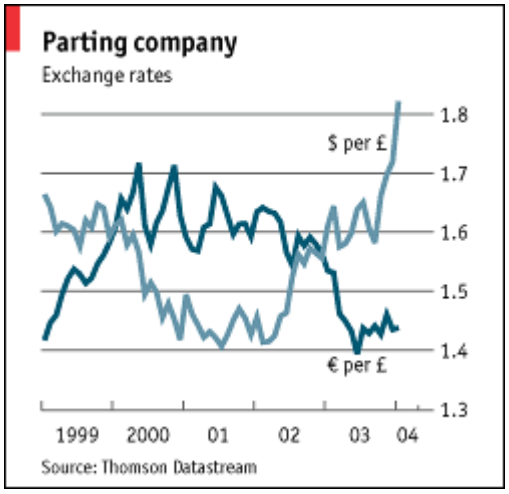
The pound is riding high against the dollar, but it won't hurt the economy



THE pound rose above $1.80 this week for the first time since it was thrust out of the European exchange-rate mechanism in September 1992. In the past five weeks alone, sterling has jumped by 5% against the dollar.

Like the euro (see article), the pound has been appreciating against the dollar for the best part of two years. Until recently, however, sterling rose less than the euro because the pound itself was falling in value against the euro (see chart). Thus between the end of March 2002 and last August, the euro gained by 26% against the dollar, and the pound by 11%.

The pound occupied its “usual halfway house between the dollar and the euro”, says David Bloom, currency strategist at HSBC, a bank. This pattern arises because the British economy tends to move more in line with America than with the euro area, even though it trades more with Europe. This in turn reflects the continuing strength of deep-rooted commercial ties between America and Britain: for example, American firms account for a much bigger share of the stock of inward investment in Britain than in the euro area.

However, since the summer there has been a further sharp bout of dollar depreciation. And this time, the pound has kept pace with the euro's appreciation. The pound has been caught up in the “capitulation of the dollar as traders desperately search for other currencies to purchase,” says Mr Bloom.

The pound has also been buoyed by the higher yields on offer for money deposited in Britain. In November, the Bank of England hoisted its base rate to 3.75%, well above the euro area's 2% and America's 1%. Although the Bank left rates unchanged on January 8th, the financial markets are expecting another rise to 4% in February, making Britain even more attractive to footloose international funds.

At above $1.80, the pound is over-valued. In the eleven years after Britain's ejection from the ERM, the pound fluctuated in a narrow range between around $1.40 and $1.70. According to the OECD, its purchasing-power parity (PPP) against the dollar—the exchange-rate which equalises the cost of a common basket of goods and services in the two countries—is $1.53.

But PPP exchange-rates are not a good guide to short-term currency moves. Mr Bloom thinks the euro will rise further against the dollar. However, he also thinks the pound will revert to its usual pattern of giving up some ground against the euro. So he is not expecting sterling to rise to $2; instead he is forecasting that it will remain a bit above $1.80.

In contrast with the euro area, the economic impact on Britain of the falling dollar should prove quite bearable. Britain trades three times as much with the euro area as it does with America. Reflecting this, the trade-weighted index of sterling is still about 5% lower than in early 2002 because of the pound's fall against the euro. Despite sterling's new-found strength against the dollar, the economy will continue to benefit from this overall devaluation.

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Cathedrals

Moral hazards

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England's popular cathedrals fear being victims of their own success

CONSIDERING that virtually no one lives in its notional fiefdom on London's South Bank, Southwark Cathedral does a decent job of luring the devout, the historically minded and the merely curious through its ancient portals. Up to 400 worshippers, including a good sprinkling of the wealthy youngsters who are busy gentrifying the nearby wharfs and warehouses, attend its main Sunday service: numbers have doubled in the last three years or so, in a sign that a market exists for formal singing and well-turned sermons. During the week, its restaurant, shop and conference centre, as well as the cathedral itself, are a draw for hospital workers, market stall-holders and yuppies in search of serenity. In a neighbourhood once thronged by friars, pilgrims, criminals and beggars, school parties are encouraged to visit the cloisters and absorb their history.

By redefining themselves as cultural and educational centres, rather than simply houses of prayer, some of Britain's 42 cathedrals have found a survival strategy. In a few cases, this has gone badly wrong; the worst was Bradford Cathedral, which faces liabilities of £4.5m ($8.2m), and litigious creditors, after the failure of an inter-faith exhibition centre. But that is an exception: in a nation where many like history and beauty but few are formally religious, cathedrals must rank as one of the church's success stories.

But places like Southwark have little time to rest on their laurels: they are girding themselves for yet another of the Church of England's rancorous internal battles, this time over money, not sex. At the moment, the Church Commissioners—stewards of the Anglican Church's historic assets, amounting to £3.7 billion or so—send about £25m a year straight to cathedrals and bishops, helping with salaries and maintenance. A similar amount goes to parishes and missions at the coal face of ecclesiastical life. The aim of all these hand-outs, says a law of 1840, is the “cure of souls in parishes where such assistance is most required”.

But do cathedrals and bishops deserve such a large, automatic share? A senior church committee has questioned the current system of entitlements. It suggests that a slice of this money be redirected to a mission fund, to be parcelled out by middle-ranking worthies known as diocesan committees. The sums at stake may be smallish, but the moral issues—say the protagonists—are big. To Southwark Cathedral's Canon Andrew Dunn, it sounds as if his part of the church is being victimised for its high achievements. “They say the idea is to direct more money towards new expressions of faith—but that's what we are engaged in now, and very successfully.” The danger is one familiar to welfare states around the world: reward those who fail, and those who were doing well give up.

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Supermarkets v the high street

The grandees fall behind

Jan 8th 2004
From The Economist print edition

The Wal-Mart effect on the big high-street names

Get article background

BOOTS, Marks & Spencer, WH Smith: three of the most venerable names on the high street, and all in trouble. There are differences in degree and cause, but one common factor. Call it the Wal-Mart effect: the push of the one-time grocers, today's supermarkets, into non-food sales.

WH Smith was a great name indeed in late-Victorian days. Selling newspapers brought its then boss a country estate and a career in politics, and would have made him that rarity, a peer risen from vulgar “trade”, had the Tory party not needed him in the Commons. But the glory is over. A new chief executive, Kate Swann, took the reins in November, and a week ago the company issued a grim Christmas trading statement and profits warning, and showed the head of its British retail operations the door. Ms Swann's predecessor, Richard Handover, retains the chairmanship that he stepped up to in November, but not all investors are sure quite why.

The new team readily lists a kitchen-sinkful of basic retailing errors. But the trouble goes deeper. You can buy books, CDs and DVDs more cheaply from specialists, supermarkets and the internet. Stationery is cheaper in supermarkets. Newspapers and magazines, Smith's traditional staple, are the same price in supermarkets; but why go to WH Smith when you're in Tesco for your groceries anyway?

That steady flow of shoppers is the supermarkets' in-built advantage. It was this—and the wit to grasp it to sell umpteen lines besides food—that made America's Wal-Mart the world's biggest retailer. That dominance was extended when it took over Asda, a lively, low-price, northern-based British supermarket in 1999. Asda and Tesco were already into non-foods, but Wal-Mart's arrival gave both a big push. On estimates from Taylor Nelson Sofres, a big market–information consultancy, Asda now sells over £2 billion a year of non-foods (petrol excluded), against £8.5 billion of food and drink, and the big three—J. Sainsbury is the lagging third—now sell in non-foods about 5% as much as the rest of Britain's retailers put together. Their range pulls customers in, their buying power keeps prices down.

Not all retailers had a gloomy Christmas: Matalan and Austin Reed were already doing poorly, yet John Lewis and, notably, Next have been happy enough. But Marks & Spencer is another sufferer. Few expect good news in its trading statement, due on January 14th.

Marks has come far since its dire commercials of three years ago showing how nice it was to be over-weight and look over 40; as many women are, but saying so is not how you sell clothes to them. Last spring it launched a new range, hung on slim and pretty models visibly under 25, and for a time a revival seemed to be under way. Not in the run-up to Christmas, though. The reports of disaster then were overdone, and ready-meals were selling well. But the season did not bring joy.

Again, look at the supermarkets. Tesco and Sainsbury both sell high-quality prepared dishes; Tesco and Asda are firmly entrenched, and rapidly growing, in clothes; and all three are strong in the “homewares” which will get a new Marks store all of their own in Gateshead next month.

And then there's Boots “the chemist”—well, the chemist and optometrist and friend of the beautician,

photographer, cook, tights-wearer and even midday-sandwich-eater, and more; and none too brilliant in any of these roles. Its new chief executive, hired last autumn from Asda, publicly savaged what he'd found: mostly for basic retail failings, but Boots too has to face not only cheap and cheerful Superdrug but the supermarkets, head-on. They sell much of what it does, including over-the-counter medicines. Between them, Tesco, Asda and Sainsbury alone sell over £2 billion a year in toiletries and health-care products, against Boots's total turnover of some £5 billion; and Tesco this week launched a package of price cuts openly aimed at it.

Price cuts? Who needs them to beat Boots? Ten Gillette Blue-II razors cost £2.45 at Sainsbury, £2.49 (in a pack of 20) at Tesco, £2.69 (currently cut to £1.99) at Superdrug—and £3.52 at Boots.

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Woolworths

The oddball

Jan 8th 2004
From The Economist print edition

A surprising survivor

WOOLWORTHS is the nutty cousin among Britain's retail nobs. By today's standards, it shouldn't exist. Who would invent a store that used to sell just about anything so long as it was cheap, and even now has no one dominant range but half a dozen—sweets, clothes, saucepans, CDs, toys and more; whose customers, on average, spend no more than £7 or so per visit; that turns over £2.8 billion, yet, though modestly profitable over a full 12 months (£38m, pre-tax, to last February) loses money solidly (£36m from last February to August) in most of them? Little wonder that when its then owner, Kingfisher, floated it in 2001, analysts foresaw its shares drifting down. In fact the price rose a third in the first day's trading.

The paradoxes run on. The shares this week were close to their 12-month high, after a less than glorious Easter—an important season for a shop that sees “children and celebrations” as its key to success—and a Christmas that may prove to have been no better.

The reason for that, though, is ordinary enough: whatever its trading update due on January 15th may show, and whatever the management's efforts to push up sales in its off-seasons, the wonder of Woolies is not its trading but the sites it has that others might make better use of. Not least, among its 800-odd mainly high-street stores, 18 “big W” ones out of town—just the sort of large stores that an ambitious supermarket, facing planning restraints on new building, might like to lay hands on. Here, in sum is—and has been from the day it was floated and analysts got it so wrong—a potential takeover target.

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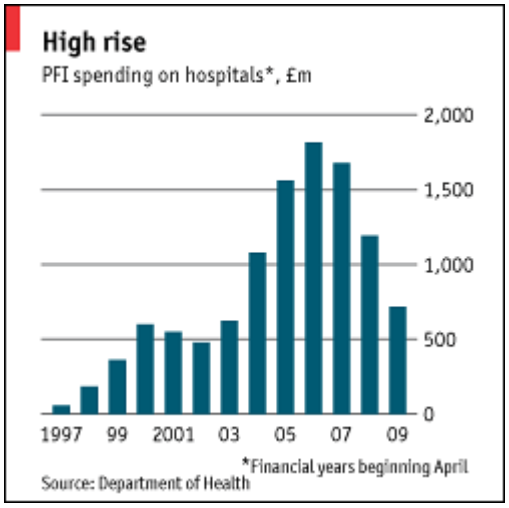
Health service

PFInancing new hospitals

Jan 8th 2004
From The Economist print edition

Will £11 billion-worth of new hospitals transform impressions of the NHS?

Get article background



CENTRAL LONDON is peppered with tower blocks housing businesses. Soon it will have a new one for patients. The shell of the 18-floor building overlooking the Euston Road is in place and the new University College hospital is due to open in April 2005.

The new hospital is replacing four—University College, Middlesex and two smaller ones—each of which is over 40 years old. Patients will no longer trundle from the emergency department at University College to wards at separate sites. Medical staff will save time and have the latest equipment. So although the new building will add only ten beds to the existing 715, it should raise in-patient capacity by 10%.

Altogether, University College London Hospitals (UCLH), one of the 176 “trusts” which organise acute medical care in England, is investing £422m in the project. Sixty-eight such schemes are set to transform Britain's ageing hospital buildings, many of which are older than the 55-year-old National Health Service.

This huge programme is gathering momentum. Since Labour took office in 1997, it has delivered investment worth about £3 billion (see chart). By 2010, the cumulative spending on major hospital renovations will have jumped to over £11 billion. An additional billion pounds is being invested in 46 smaller schemes.

Patients seem sure to welcome spanking new buildings replacing grotty, run-down hospitals. At UCLH's high-rise, patients will have bedside phones and screens for television, the internet and e-mail, which will also come in handy for doctors viewing their records. By 2010, as many as one in four patients nationwide will be benefiting from the new hospitals.

The building programme is, however, controversial—largely because so much of it is funded through the Private Finance Initiative (PFI). At UCLH, this means that a private consortium is raising most of the money. Over a 35-year period, UCLH will pay for capital, interest and ancillary services such as cleaning, catering and portering. If it were an old-style public investment, the Treasury would borrow the money and hand it to the NHS which would procure a new building. In both cases, the taxpayer foots the bill but with PFI more is shunted into the future.

Of the 68 big schemes, 64 are being funded through PFI. The four publicly financed schemes will contribute less than £200m out of the £11.2 billion investment programme. Hospital managers like Peter Burroughs of UCLH say they chose PFI because it offered better value for money than a publicly financed alternative, even though the government can borrow more cheaply than private firms. But they accept that PFI is the only game in town. Mr Burroughs says simply: “Without PFI, we wouldn't have had a new hospital.”

One issue about the new hospitals is their quality. Mr Burroughs says the private sector has produced “a very sophisticated building”. However, Jon Rouse, chief executive of the Commission for Architecture and the Built Environment, worries that it will be “cramped and over-developed”. According to CABE, the standard of design in most of the first wave of PFI hospitals has been “low”.

Mr Rouse stresses that CABE is not just complaining about aesthetics: “What concerns us is the functionality of the building in delivering the best possible medical services and patient environment.” Subsequent PFI hospitals are likely to improve as the NHS learns from mistakes. But Mr Rouse maintains that “PFI is failing to generate innovation in the delivery of hospital services because what the private sector wants is low-risk, low-cost solutions”.

The most important concern about PFI is whether it will deliver long-term value for money for the NHS. Early PFI hospital deals examined by the National Audit Office (NAO) are expected to provide savings of 3-4% compared with a publicly financed procurement. The government is now seeking further economies by grouping individual schemes together, which the private consortium then develops in batches. But any gains from this strategy are likely to be more than offset by higher costs since the government bowed in 2002 to union demands that most ancillary workers in PFI hospitals should remain NHS employees.

One clear advantage in PFI projects, according to the NAO, is that they are usually built on time and on budget—a marked improvement on previous experience. But the NAO has also drawn attention to the “particular risks from being locked into a long-term contract as part of a PFI deal”—the potential loss of flexibility in responding to changing health-care needs, for example, from local population changes. A broader concern is that the PFI programme will perpetuate the current NHS model of expensive hospital-based health care. Many people think that the government should be trying to shift more care out of hospitals and into cheaper clinics and doctors' surgeries.

Labour hopes that the new hospitals will modernise not just the physical fabric but also the image of the NHS. It may do. Bright new buildings cheer people up. But if they turn out to be a waste of money, the gripes may not go away.

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Bagehot

Howard's burden

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The Tories' euphoria is dangerous for Michael Howard

ELEVEN weeks ago, under the now almost completely forgotten Iain Duncan Smith the Tories were hapless and hopeless, a divided rabble headed for political oblivion. Today, they are resurgent and reinvigorated, a disciplined fighting force marching confidently forward. That, at any rate, is the story. And as with most good stories, the fact that it is only partly true doesn't matter. What does is that almost everyone, for their own reasons, has decided to believe it for the time being.

By collectively resolving to elect Michael Howard unopposed, Conservative MPs surprised themselves. For the first time in ages they had done something that wasn't crazily self-destructive. Simultaneously, nearly 15 years after it first went missing, they rediscovered the capacity for unity. If Mr Howard can achieve this miracle in such short order, what else might he be capable of? Merely by conducting himself as the tough and intelligent old political pro that he is, Mr Howard has managed to create an impression of forward momentum.

The political media has thus far happily played its part. It is bored with useless Tory leaders and with Tony Blair's ascendancy. Mr Howard may not be a new face, but he can be turned into a new story. For politics to become “interesting” again, Mr Howard must be made a success.

So whenever Mr Howard lands a blow on Mr Blair during prime minister's question time there are gasps of admiration from the press gallery, while the transformation of morale and discipline under Mr Howard is something to be marvelled at. When, in a two-page advertisement placed in the *Times* last week, Mr Howard set out his “credo”, a clumsy mixture of the platitudinous and the ambiguous, the newspaper editorials were unusually kind. If Mr Duncan Smith (or, come to that, Tony Blair) had come up with the same stunt, it would have been greeted with loud guffaws.

Even the government seems quite keen to build Mr Howard up. Iraq may have been the catalyst for the new mood of rebellion on the Labour benches, but it was Mr Duncan Smith who made it seem relatively risk-free. It suits government whips, desperately trying to impose a little order, to draw blood-curdling attention to the seriousness of the threat posed by Mr Howard.

That he has got off to an impressive start is not in doubt. With the exception of his bizarre antagonism to top-up fees and his toe-curling “credo”, Mr Howard has hardly put a foot wrong. But his early success and the hopes it has aroused have created dangers of a new kind both for his party and himself.

Few Conservative MPs or their supporters in the country really think that Mr Howard will be forming a government after the next election. But ideas about what would constitute a “result” for the Tories are nonetheless growing in ambition. MPs who a few weeks ago would have been pretty pleased if the party ended up with 200 seats (against the 166 the Conservatives took at the last election) are now defining success in terms of winning between 220 and 240 seats.

Unfortunately for the Tories, what sounds as if it should be perfectly achievable is actually setting the bar dauntingly high. In the first place, although there are some signs of upward movement after flatlining in the opinion polls for a decade (at a little above or below 30%), any improvement since Mr Howard became leader has been at the expense of the Liberal Democrats rather than Labour. A Populus poll this week in the *Times* put Labour on 40%, the Tories on 35% and the Lib Dems on 18%. So far, the Howard effect, such as it is, has been a re-polarisation of politics rather than an erosion of Labour's dominance.

That could still change. Mr Howard's troops can't wait for him to start ripping into Mr Blair over the Hutton Inquiry later this month. However, at this stage, it is hard to imagine anything other than a

collapse of confidence in the economy propelling the Tories to within spitting distance of their unofficial target.

It ain't fair

The reason for such pessimism is the savage bias against the Tories that has been gradually built in to Britain's electoral system. A few examples illustrate their plight. Based on a uniform swing from 2001, to reach even the bottom end of their expectations— say around 224 seats—the Conservatives would need a 37.5% share of the vote. With exactly the same number of votes, Labour would win 140 more seats and have an overall majority of about 70. To gain an overall majority of just one seat, the Conservatives would require an 11.5 point lead over Labour.

Peter Kellner of YouGov, a polling company, points out that although over-representation in Wales and Scotland (worth 13 seats to Labour) should eventually be rectified by the Boundary Commission, boundary changes don't keep up with demographic change. Labour constituencies have on average 6,000 fewer electors than Tory ones because of the long-term drift of population from the cities to the suburbs and the shire counties. Turnout also tends to be lower in Labour seats. Together, this means a bias worth about 18 seats to Labour.

To get to 37.5% or a bit more doesn't sound impossible. But the Conservatives also suffer from Labour and Lib Dem voters ganging up to keep out Tory candidates. Mr Kellner estimates that tactical voting, which may now have become “embedded”, costs the Tories 43 seats. Finally, just because of the scale of its two landslide victories, Labour is likely to hold on to about ten seats in marginal constituencies it would otherwise lose because of the advantages of incumbency.

Not all these biases are immutable, but shifting them will take some doing. A few weeks of flattering headlines and a leader who looks as if he knows what he's up to is a start, but that's all it is. Mr Howard might end up being crushed by the weight of expectation that his own early success has created.

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Airline insecurity

Fear of flying

Jan 8th 2004 | LONDON AND NEW YORK
From The Economist print edition

Reuters

Is the increased security burden for the airline industry overdue, over-hyped or simply an over-reaction?

WITH security alerts leading to the cancellation and delay of yet more flights, the world's airlines and their governments are having to adjust to a newly aggressive stance by America in the fight against terrorism. This week a raft of measures was introduced, aimed largely at what America now believes are the weakest links in the airline system: foreign carriers. While this makes air travel even more of a hassle, it also highlights the gaps that remain in America's own defences.

It also prompts two somewhat contradictory reactions. If all this extra activity is really necessary, why is it taking place only now, over two years after the September 11th attacks? On the other hand, could it be that politicians, particularly in America, are now so keen to cover their backs that they are over-reacting to the thinnest slivers of intelligence information, regardless of the cost to the airline business and the passengers who rely on it? There does not seem to be any way for passengers to know which of these two reactions is the more appropriate—nor, for that matter, just how risky it actually is for them to board a plane.

The ramping up of security began on December 21st with a declaration of “Code Orange”, America's second-highest state of alert. Since then, several dozen international flights have faced rigorous scrutiny. Six Air France flights to Los Angeles were cancelled. A British Airways flight to Washington, DC, was held for two days in London while it was repeatedly checked. A flight from Mexico was turned back from America, and several aircraft were shadowed by F-16 fighters. Even when safely on the ground, some foreign jets were parked far away from terminal buildings.

On December 29th Tom Ridge, the head of America's Department of Homeland Security, gave warning that foreign airlines would be denied landing rights if they failed to put armed guards on flights America considered to be at risk. Some countries, such as Singapore and Australia, have already complied. Others are considering how it can be done and, like Britain, are negotiating with their pilot unions. But airlines in countries ranging from South Africa to Portugal and Sweden said they would rather cancel flights than carry armed guards. They may have to. America seems to be in no mood to compromise.

Say cheese

On January 5th America launched its long-planned programme to fingerprint and photograph all visitors with visas arriving at airports and seaports. Both are scanned digitally in 15 seconds. Tourists using America's visa-waiver programme will be exempt until October. Any new passports issued after that will have to contain fingerprints to qualify for a visa-waiver. Eventually, similar checks will be carried out on departure. Reactions to this have also been mixed. Brazil was so incensed that a judge ordered all American visitors to be fingerprinted and photographed.

American officials say that checks in some countries have been worryingly lax. Recent intelligence reports suggested that terrorists might use overseas carriers to mount a September 11th-style attack on America, perhaps crashing into a nuclear power station. Foreign pilots are also being screened—and in two cases banned.

America has tightened up its requirement for passenger information. Foreign airlines must transmit passenger manifests within 15 minutes of departure or risk fines of up to $6,000 per passenger. These are checked against lists of suspected terrorists and criminals. But the lists contain only limited information. People with names similar to suspects have been getting a grilling. A series of mistaken identities was involved in the grounding of the French flights: one suspected terrorist turned out to be a child and another a Welsh insurance agent.

Such problems are compounded because America still does not have a single, up-to-date watchlist. After the September 11th attacks it was considered essential to consolidate the 12 databases used by nine agencies. It turned out that America's Central Intelligence Agency had put two of the hijackers on its own list of suspects, but informed other agencies only after the pair had already entered the country.

Last April America's General Accounting Office said that efforts to share information were still being hindered by technical and bureaucratic problems. On December 1st a new body run by the FBI, the Terrorist Screening Centre, was opened to oversee the task. It faces months of work before it can hope to become the single point of contact for terrorist checks.

America can justify throwing its weight about in part because it is no longer the weakest security link in the international airline system. Before September 11th, America inspected only 5% of checked baggage and used only 33 armed guards, known as sky marshals, to protect sensitive flights. Now all one billion bags checked on to international flights in America each year are (supposed to be) inspected and tens of thousands of flights each month carry sky marshals.

Yet gaps remain. Not all baggage on domestic services is screened and little air cargo is inspected. Chuck Schumer, a New York senator, claimed this week that more than 22,600 aircraft carrying unscreened cargo fly into New York's airports each month. In September a man was able to ship himself inside a box on a cargo plane from Newark to his father's home in Dallas. The authorities are belatedly starting to tighten up a little, but not enough. Cargo pilots, like those on passenger jets, will be able to carry guns.

But on-board weapons, whether carried by pilots or marshals, worry many pilots outside America. Low-velocity bullets might not penetrate a fuselage, but they could still damage vital hydraulic and electrical systems. On the other hand, pilots are also concerned that knives made from Kevlar or ceramics could pass undetected through airport scanners. Some fear that ways will be found to force the hardened cockpit doors with which passenger jets (but not yet cargo ones) now have to be fitted. Still, if there are future hijacks, passengers are at least likely to fight rather than trust terrorists to let them live.

A growing worry is missile attack, particularly when planes are close to the ground during take-off and landing. As a precaution, some military aircraft deploy flares as they come in to land, to lure away any heat-seeking missiles. But this is not entirely appropriate for use at civil airports in densely populated areas. An alternative could be avoidance technology or fitting lasers that hit missiles. This week America awarded three contracts to study the feasibility of developing such systems. Some pilots want better monitoring of potential missile-launch sites around airports.

The biggest uncertainty concerns the nature of the threat, and government reaction—or is it over-reaction?—to intelligence about possible attacks. Unless the intelligence is published, which it will not be, it is easy to suspect political back-covering. And yet, as Jack Straw, Britain's foreign secretary, observes, “When there is a fine judgment to be made, we come down on the side of passenger safety, and no one would forgive us if we failed to do that.” He is probably right. This means that passengers are simply going to have to get used to the hassle of tighter security, and more mystifying delays, and airlines to the costly headaches these cause.

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Litigation risk

All American now?

Jan 8th 2004
From The Economist print edition

The Parmalat scandal highlights the global spread of American legal risk

AS ITALIAN magistrates continued to amass evidence against Parmalat executives this week, most of the big news was, curiously, being made in America. True, Calisto Tanzi, imprisoned founder of the bankrupt, fraud-ridden milk group, offered to put his personal assets at the disposal of Enrico Bondi, who is trying to find a missing €8 billion ($10 billion). But, as someone close to Mr Bondi put it, what use to creditors is a bunch of yachts with crews who have not been paid for months?

For all his public tears, Mr Tanzi has been unco-operative with magistrates and Mr Bondi. He refuses to say where the missing billions might be or whether they exist at all. His motives and exact methods are unclear. Mr Bondi is reportedly growing frustrated, not least because raids by magistrates mean that confiscated documents are not available for his own efforts to track Parmalat's cash. After a fast start, the Italian investigation is slowing down.

In contrast, in America things are speeding up. The Securities and Exchange Commission (SEC) has widened its probe into $1.5 billion-worth of bonds sold by Parmalat in America. It wants to know whether American banks, which helped to place the bonds with investors, were wilfully ignorant of the firm's problems. On January 5th, Milberg Weiss Bershad Hynes & Lerach, a law firm specialising in shareholder lawsuits, proudly announced victory in the race to file the first suit against Parmalat's executives, lawyers, bankers and accountants, and demanded that the insiders promptly pay $1 billion.

Meanwhile, the US attorney's office for the Southern District of Manhattan—an outpost of the Department of Justice (DOJ) that has brought to trial celebrity ex-bosses such as Martha Stewart, for whose case jury selection began this week—let its interest in the Parmalat scandal be known. Even Robert Morgenthau, Manhattan's elderly district attorney, confirmed his office's involvement in the investigation. For once, Eliot Spitzer, New York state's attorney general, looked upstaged.

Foreign firms that come to America to sell shares and bonds have long understood, at least in theory, that they face the scrutiny of American regulators, public prosecutors and its ravenous trial lawyers. Exploiting these anxieties, American insurance firms began selling policies for directors and corporate officers world-wide as far back as the late 1980s.

Today this threat no longer seems primarily theoretical. Since 1995, says PriceWaterhouseCoopers, an accounting firm, over 100 foreign firms in America have been sued in private litigation or cases brought by the SEC or DOJ. Recent settlements have involved DaimlerChrysler (for $300m), Alcatel ($75m) and Baan ($33m). Both the SEC and DOJ are investigating Ahold, a Dutch retailer which suffered accounting fraud in its American arm. In fact, calculates Dan Dooley of PriceWaterhouseCoopers, a foreign firm registered with the SEC is a bit more likely to face a lawsuit in America than an American firm.

These numbers partly reflect the greater globalisation of the world's capital markets, as foreign firms increasingly raise money in America. In 1992, 517 foreign firms were registered with the SEC; in 2002, there were more than 1,300.

But Parmalat is rapidly raising awareness of such jurisdictional risks. Much of Parmalat's debt mountain was financed by international banks. Bonds ended up in the portfolios of mutual funds, as well as big American life assurance firms, notably AFLAC, which has a reported $428m of exposure. One of the blackest holes is in Brazil, where former finance directors of Parmalat say acquisitions were done at inflated prices, partly to pay bribes. And authorities in the Netherlands are investigating how Parmalat's subsidiary there managed to issue €4.45 billion in bonds.

The upshot of all this is that problems such as Parmalat's must be sorted out in a highly uncertain and complex regulatory and legal environment. Even within Italy Mr Bondi is administering Parmalat under a completely new bankruptcy law, rushed through last month. Creditors are also starting to wonder if, assuming they win any American lawsuits, they can enforce any judgments against Parmalat and its disgraced bosses. It is not just a question of whether a bankrupt firm can pay. There is no clear set of rules across rival capital markets as to the priority given to different groups of creditors and investors.

Nor is it clear which set of courts has priority. On Parmalat, Italian courts will have the first say. But what then? Arguments are already starting about the ownership of “assets” that should have been in Parmalat's offshore web. In short, Parmalat highlights a big new challenge for firms, particularly those with foreign assets.

The American way

Two trends suggest that American standards will gradually triumph. The first is an effort by America's trial lawyers to globalise their industry. Melvyn Weiss, the senior partner at Milberg Weiss, recently toured Europe to drum up interest among European institutional investors: might they be willing to put themselves forward as plaintiffs in shareholder suits brought against European firms in America?

Innovative uses of America's ancient Alien Tort Claims Act, meanwhile, may encourage more American lawyers to form classes of aggrieved investors in London, say, and attach them to a suit in America. Such methods were used recently against DaimlerChrysler and Cable & Wireless, says Darren Robbins of Milberg Weiss.

Mr Robbins adds that his firm's suit against Parmalat is on behalf of all investors in the firm, everywhere. So long as European countries fail to provide private civil remedies for fraud (in most of Europe, the lack of a class-action mechanism makes it too costly and cumbersome), trial lawyers will continue to seek American jurisdictions for European claims.

The second trend is the perception that, as in war, American multilateralism is giving way to unilateralism, as it exports wholesale its accounting rules, standards of corporate governance and securities regulations. Foreign firms have until recently enjoyed a degree of regulatory forbearance in America, with different accounting and disclosure standards and some deference to the ability of foreign regulators to keep an eye on their own.

But, to horror abroad, the Sarbanes-Oxley act of 2002, whose anti-fraud provisions go deep into a firm's inner workings, makes no distinction between American and foreign firms. Despite bitter foreign complaints, America has stuck to its guns.

The recent scandals at Parmalat and Ahold are only likely to strengthen American resolve to be tough on foreign firms. American emphasis on personal accountability at the top and the growing use of criminal, rather than civil, prosecution (with sentences of up to 25 years) pose huge cultural and legal challenges for those European firms used to a cosier relationship with their governments.

This all creates more opportunities for trial lawyers. “Foreign firms are way behind in their documentation and the way they handle transactions,” says Mr Weiss.

Meanwhile, foreign accountants that audit American or foreign firms registered on American exchanges must answer to the SEC and a new regulator, the Public Company Accounting Oversight Board, as well as the jurisdiction of American courts that want to subpoena documents, for instance. In some cases where a foreign accounting firm has resisted the SEC's request for papers, the SEC has launched proceedings against its American affiliate.

That could spell trouble for Grant Thornton, long-time auditor of Parmalat and some of the subsidiaries directly implicated in the fraud. Anxious to avoid the fate of Arthur Andersen, destroyed by the Enron scandal, Grant Thornton is trying to argue the principle of “local liability” in order to distance itself from its Italian operation. The boss of the firm's Italian arm has already resigned. That might not be sufficient to stop the damage from spreading.

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Entrepreneurship

Enterprising rising

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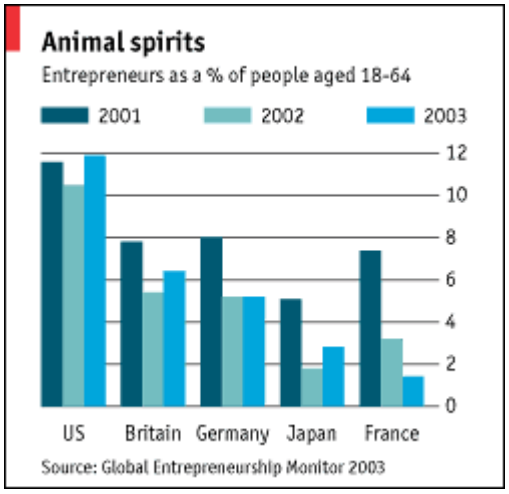
Signs of a recovery

YET more good business news. Entrepreneurial activity, badly hit by the bursting of the dotcom bubble, rose strongly last year in both America and Britain. According to the Global Entrepreneurship Monitor (GEM), a study of 40 countries by the London Business School and America's Babson College, the Japanese also became more entrepreneurial in 2003, although, less happily, such enterprise was unchanged in Germany and fell sharply in France.



The GEM defines an entrepreneur as anyone creating or running a start-up (less than three months old) or a baby business (four to 42 months). It surveys a random sample of people aged 18-64 to produce an index of “total entrepreneurial activity” for each country.

Because the opportunity—or need—to be entrepreneurial can differ sharply between countries, comparisons are tricky, particularly between rich and poor countries. Still, in 2003, America was much the most entrepreneurial big rich country, with some 11.9% of 18-64-year-olds entrepreneurs. Uganda had the highest proportion of entrepreneurs of all, 29.2%. This may point less to high rewards to enterpreneurs in Uganda than to the lack of alternative jobs.

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Working hours

Put down that tool

Jan 8th 2004 | BRUSSELS
From The Economist print edition

A still bigger regulatory burden for European businesses?

THE British work longer hours than anyone else in the European Union (EU), which may account for Britain's faster rate of economic growth in the past decade. But the European Commission wants to put a stop to it. In a recent communique it notes disapprovingly that, “The UK is the only member state where weekly working time has increased over the last decade.” The commission reckons that British companies may be systematically violating the EU's “Working Time Directive”. This ordains that Europeans should work a maximum of 48 hours a week on average. Under the directive, workers can sign an “opt-out”, agreeing to work more than 48 hours. Some 33% of British workers have signed such opt-outs, although only 16% are believed actually to be working more than 48 hours.

Anna Diamantopoulou, the European commissioner for employment and social affairs, smells a rat. Firms in other European countries have not made much use of opt-outs. But, she thinks, nasty British bosses may be forcing workers to sign opt-outs as a condition of taking a job. (Some Americans may actually want to work more than 48 hours, but surely no European would be so daft, seems to be her reasoning.) Citing rationales ranging from “health and safety” to the need to maintain “minimum social standards” in the EU and to strike a better balance between work and family life, the commission is launching a “consultation of interested parties” on possible changes to the directive. The commissioner hopes that Britain will be able to come up with solutions on a voluntary basis. This sounds innocent enough. But, in reality, if it does not, the commission will probably devise a new directive.

The commission's hope is not simply to rein in the corporate Stakhanovites of Britain. Recent judgments from the European Court of Justice have raised the prospect that the Working Time Directive will impose huge new costs on health systems across Europe. Two court rulings last year mean that periods when doctors are “on call”, but not actually working, now count as “working time”. The German government says that this will force it to hire up to 27,000 new doctors and raise health spending by €1.75 billion ($2.2 billion). Germany, the Netherlands and Spain are each drawing up legislation to incorporate the “opt-out” into their health systems.

The political implications of this make it highly unlikely that Mrs Diamantopoulou will actually propose scrapping opt-outs altogether. Instead the commission is likely to push for tighter definitions of the conditions under which opt-outs can be used. This will inevitably reduce labour-market flexibility and may introduce yet more burdensome corporate form-filling and regulation. The British government claims to welcome the commission's review. Privately, however, it hopes that the appointment of a new commission next autumn will ensure that Mrs Diamantopoulou does not have enough time to revise the directive. She will certainly need to work long hours to get it done. Fortunately, being classified as a manager, at least she has an automatic opt-out from the Working Time Directive.

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Corporate scandals, continued

Black and blacker

Jan 8th 2004
From The Economist print edition

The scandal deepens at Hollinger International

AP

Talk to the hand

THREATENED with financial difficulty, social disgrace and, perhaps eventually, even criminal charges, Conrad Black (see picture) is behaving coolly, people close to him say, and is ready to do battle in the manner of his hero, President Franklin Roosevelt, about whom he recently published an excellent biography. But things look bad for Lord Black. An inquiry that started in June into hundreds of millions of dollars that he and colleagues have received from Hollinger International, a newspaper company that he controls, is now asking tough questions amid growing pressure for money to be repaid.

In late December, Lord Black exercised his right under America's constitution not to incriminate himself and refused to testify before the Securities and Exchange Commission. That has prompted some directors of Hollinger International to consider trying to oust him from his position as chairman. (He has already quit as chief executive.) This week Lord Black failed to produce the first $850,000 installment of the $7.2m he agreed late last year to pay back to Hollinger International. Originally the money had gone to him in the form of “non-compete” fees when the company sold assets—a practice which some shareholders now argue was an abuse. Hollinger International has given Lord Black two more weeks to come up with the $850,000. Its investigation will report its findings within the next three months.

Last week it became clear that people who have served for years on Hollinger International's board—including Henry Kissinger and Richard Perle, a member of the Pentagon's Defence Policy Board—may face legal consequences along with Lord Black. Delaware's chancery court unsealed a lawsuit brought by Cardinal Value Equity Partners, a shareholder, which argues that the board gave Lord Black and his associates “an unfettered licence to line their pockets at shareholder expense.” In September 2001, for instance, the board retroactively authorised a sale of publications that had already taken place, for $1, to an investment vehicle owned by Lord Black and his colleague David Radler. Board minutes, claims the lawsuit, show that there was no discussion of why the asset was being sold, why it was being sold to people connected to the company rather than to an outside party, or of its fair value.

Meanwhile, Bruce Wasserstein, chief executive of Lazard, an investment bank, is personally working on a plan to sell Hollinger International's assets, which include the *Chicago Sun-Times* and Britain's *Daily Telegraph*. So far, says a shareholder, Lazard has received more than 100 expressions of interest and will soon send out a book of information about the assets for sale. First to go, very soon according to people close to the firm, could be the *Jerusalem Post*, an influential Israeli English-language paper, to a Jewish buyer likely to be either American or Russian. Lazard is expected to recommend selling most of the rest of Hollinger International (including the *Telegraph*) as a whole for shares rather than in bits for cash. This would let its shareholders avoid paying capital-gains tax.

Freed from paying Lord Black all his non-compete fees and management fees, Hollinger International's newspaper assets are healthy businesses on the cusp of an advertising recovery, say people close to the company. Add to that the possibility of yet more repayments to the firm and of damages being awarded. Lazard and the company's board of directors reckon they would be able to sell for at least $20 a share, a third up on the current share price, says a fund manager who bought shares in the past year confident that he would (eventually) more than double his money.

For now, much still depends on Lord Black, who controls Hollinger International through Hollinger Inc, his holding company, which has 73% of the former's voting shares. With that control he could, in theory, sack the board of directors if they try to oust him as chairman. If Lord Black cannot find new financing for Hollinger Inc, however, it could default on an interest payment in March, meaning that control of Hollinger International would pass into the hands of Hollinger Inc's creditors. That would complicate the board's efforts to find a buyer. For the next few months, at least, Hollinger International will remain a mess.

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Italian business

Soaring Sorin

Jan 8th 2004 | SALUGGIA
From The Economist print edition

An atypical Italian success

AS THE black hole grows ever deeper at Parmalat, this week brought some brighter news from the *bel paese*: the listing of Sorin, a medical-technology firm. Sorin's debut on January 5th gave a shot of fresh blood to Milan's anaemic stockmarket and showed that Italy offers more than failed food groups and traditional fashion and footwear firms. Sorin operates at technology's cutting edge.

Sorin was on the stockmarket once before, listed in 1985 by Fiat, a car firm that was then its parent. Already owning a big stake in Snia, which began as a shipping firm in which Giovanni Agnelli (Fiat's founder) had a large interest, Fiat took effective control in 1986 by transferring Sorin to Snia—and thus continued to control Sorin as well. Sorin was taken off the market and merged into Snia four years ago, about the time that Fiat shed Snia—which has now listed Sorin.

The end of this typically Italian shuffling should, at both firms, help management that has had to cope with constant upheaval and a lack of focus which meant seeking synergy in caustic soda and heart valves, synthetic fibres and pacemakers.

Yet at least there has been stabilising continuity at the top. Umberto Rosa, Snia's chairman and chief executive—who will also continue as chairman of Sorin—joined Fiat as a chemist when it was involved in nuclear engineering and, 30 years ago, took on the job of converting the group's nuclear-research centre into a medical-technology firm. He soon became unpopular by suggesting that the future lay in spending less on cars and more on health; time and Fiat's problems have proved Mr Rosa right.

As Snia and Sorin part, prospects look healthier for Sorin's scientists and production staff working on cardiovascular and cardiac devices at Saluggia, near Turin, than for the workforce staying with Snia, especially at its chemicals plant at Torviscosa near Trieste. With over 500 patents, research centres at seven of its 11 sites, including one in Austin, Texas, and with some 10% of its 4,300 workers in research and development, Sorin's assets are more interesting than those of its former parent.

Saluggia's laboratories and manufacturing facilities belie the notion that Italy can make phenomenally fast cars but is hopeless at other sorts of leading-edge technology. Sorin claims worldwide leadership in cardiac-surgery equipment such as heart-lung machines and oxygenators that provide oxygen to the blood in open-heart operations, and co-leadership worldwide in making mechanical heart-valves. Around 300,000 of its valves have been implanted over the past 30 years, with no reports of any post-operative mechanical failures. There is no room for error, remarks Mr Rosa.

The company is also unusual by Italian standards for its acquisitiveness overseas. The American market, with its technological edge and higher prices, is crucial to Sorin's ambitions. In November 2002 it bought CarboMedics, a heart-valve maker based in Austin, for $116m. In 1999, it bought Cobe, a maker of products for cardiac surgery based in Denver, Colorado. In 2001, it bought ELA Medical, a French maker of cardiac stimulators.

Sorin's medical-technology sales rose from €340m ($379m) in 1998 to €710m in 2003. Profits are now €90m. As for the future, the number of heart-valve installations is expected to rise only modestly, from about 250,000 in 2002 to 280,000 in 2007. Sorin is pinning its hopes for growth on the currently hot business of coronary stents, devices that are inserted into arteries. Globally, some 2.3m stents were put into patients in 2002, a total expected to rise to 4.3m in 2007. Ageing populations and unhealthy lifestyles—as much a problem in Italy as elsewhere—are certainly good for business.

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The chip industry

Broken China

Jan 8th 2004 | NEW YORK
From The Economist print edition

America's powerful semiconductor lobby picks a fight with China

FOR all the tough talk recently from American politicians about manufacturing jobs lost to China, few serious disputes have yet emerged to threaten trade relations between the two countries. But soon Americans could be exercised about something a bit more strategic than the Chinese wooden bedroom furniture and bra imports that George Bush has seen fit to focus on so far. In the next few weeks, directors of America's powerful Semiconductor Industry Association (SIA) will meet to vote on whether to ask President Bush to take action against China for a breach of World Trade Organisation (WTO) rules. This would be the first such action by any country since China joined the WTO in 2001. The SIA's president, George Scalise, says that his industry plans to pursue its grievance “aggressively”.

The issue is how China taxes sales of semiconductor chips. Imported chips are subject to a value-added tax (VAT) of 17%. But those produced in China qualify for tax rebates that lower the effective tax rate to 6% (for chips made in China) or 3% (for chips designed and made in China). With $19 billion a year in sales, China is the third-largest consumer of chips in the world—and, crucially, the world's fastest-growing market.

Unlike other suffering American manufacturers, such as textile firms, chipmakers use far more capital than labour. In fact, some of the latest chip-wafer fabrication plants (“fabs”) employ no people at all. As a result, calculates the SIA, overheads in America are only 10% higher than Chinese costs. This suggests that there is little innate advantage for Chinese manufacturers. By taxing imported chips much more heavily, says the SIA, China has had a big impact on where fabs are built—mainly by attracting Taiwanese producers to build new fabs in Shanghai, Songjiang, Beijing and Suzhou. Research commissioned by the SIA found that, since China introduced its VAT rebates in 2000, Taiwanese firms have built eight new fabs in China and plan to open another 11, threatening American exports.

Having hinted earlier that it might change its tax regime, China now appears to be suggesting that it sees no problem with the way it taxes chip sales, says Mr Scalise. President Bush may try to buy off the SIA with a tax break of his own, such as a more friendly capital-depreciation schedule for American chipmakers. Otherwise—and especially in an election year—he could find the industry's well-argued case hard to resist.

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Face value

Hello, Moto

Jan 8th 2004
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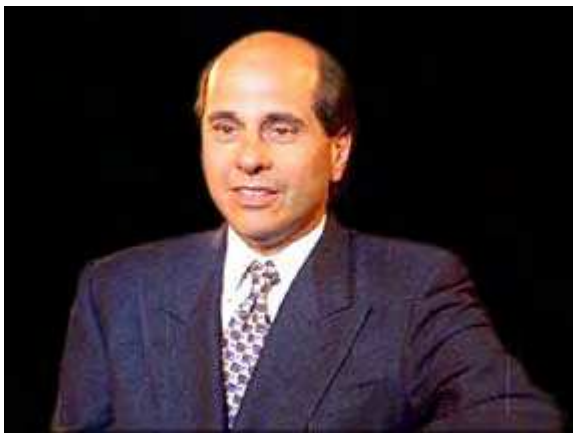
AP



What direction will Motorola take under its new chief executive, Ed Zander?

WHEN Ed Zander took over as the new boss of Motorola on January 5th, one of his first meetings was with his predecessor, Chris Galvin. The two men could hardly be more different. Mr Galvin is known as a sympathetic, thoughtful man who measures his words carefully; Mr Zander, in contrast, is a hard-charging fast talker who never hesitates to speak his mind. Mr Galvin, the grandson of Motorola's founder, has strong emotional ties to the firm; Mr Zander, formerly the number two at Sun Microsystems, a computer-maker, is an outsider with a reputation for no-nonsense decision-making. Mr Galvin resigned in September after disagreeing with the board over the pace and direction of change. The nature of this dispute has not been revealed, but the decision to hire Mr Zander, passing over Mike Zafirovski, the leading internal candidate, suggests that the board thinks that Motorola needs a dose of strong medicine, best administered by an outsider. But what sort of strong medicine?

By his own admission, Mr Zander does not yet know. He plans to spend his first few months scrutinising every aspect of Motorola's sprawling empire, and familiarising himself with a high-tech conglomerate that has little in common with Sun. Motorola's largest business (40% of revenues) is its mobile-handset division, which makes products aimed at consumers—not the governments and large firms that make up Sun's client list. But Motorola also makes microchips, television set-top boxes, cable modems, home-theatre equipment, emergency radios, wireless communications infrastructure, networking equipment and automotive electronics. At this week's Consumer Electronics Show in Las Vegas, it even unveiled a new range of flat-screen TVs—re-entering a market it had abandoned in the 1970s.

Unlike Sun, which knows its enemies (indeed, it bangs on about them rather too much), Motorola thus competes against hundreds of firms in dozens of markets. As a result, it suffers the classic inefficiencies of a conglomerate. It is too thinly spread to compete vigorously in all these markets. Nor does it benefit from its scale: quite the opposite, in fact. Motorola's divisions are, in effect, run as separate firms that are akin to fractious children vying for parental attention. Each division has its own strategy team. Occasionally, Motorola articulates a seemingly coherent overall strategy—but then, say analysts, it usually fails to deliver.

Mr Zander's job is to sort out the mess, improve operational efficiency and above all to work out where Motorola goes from here. Rather than spin off poorly performing divisions, Mr Galvin preferred to make excuses and promise that things would get better eventually. Soon after his resignation, Motorola tellingly announced its intention to spin off its ailing chip-making division. The decision to hire Mr Zander, who will have fewer qualms than an insider when it comes to paring the firm down, suggests that the board wants him to continue on this path.

One option would be to copy Nokia, which overtook Motorola in the 1990s to become the world's leading maker of mobile handsets. Motorola once ruled this market, but its share is now 15%, compared with Nokia's 35%—and Samsung, the number three handset-maker, is catching up fast. Nokia's trouncing of Motorola is due to its single-minded focus on handsets, its understanding of the importance of design and its superior operational efficiency. Motorola has recently woken up to the importance of design. Its phones are not as fiddly as they once were. But parts shortages meant it was late to market with camera-phones, now the fastest-growing category. Its handset division is horribly inefficient by industry standards—its margins are just 3%, compared with 23% at Nokia and 20% at Samsung.

Copying Nokia would entail fixing these operational problems—something for which Mr Zander is well qualified—and selling off most of the rest of the firm. Motorola has considered swapping its struggling wireless-infrastructure division for Siemens' handset business, boosting its market share to nearly 25%. (Mr Galvin was opposed.) But concentrating solely on handsets would be risky. Motorola's technology is respected. But the firm seems to lack a good grasp of what consumers want—an area where Mr Zander also lacks experience. And, although the handset market is growing at 6-7% a year, competition is intensifying.

A radical alternative strategy would be for Motorola to quit the handset business before its market share is eroded any further (rather as Ericsson did), and to retreat from other consumer markets. This would preserve Motorola's engineering culture and enable it better to defend the emergency-radio business, currently a cash cow, where it could all too easily lose its dominance, as it did in mobile phones. Mr Zander would no doubt feel more at home focusing on corporate and government markets. But it is difficult to imagine Motorola selling off its handset business, at least until Mr Zander has had a go at fixing it.

The vision thing

So the most likely course is somewhere between the two: expect Motorola to drop some product lines, improve efficiency and attempt, Samsung-like, to capitalise on the convergence between communications and entertainment. Is that a bold enough vision? Mr Zander is fond of pointing out that when Lou Gerstner took over at IBM in 1993, he refused to articulate a grand strategy, insisting that “the last thing IBM needs now is a vision”—before pulling off a legendary turnaround. At Sun, Mr Zander performed a double-act with his boss, Scott McNealy, filling in the practical details and talking to customers while Mr McNealy talked up the firm's ambitious strategic visions. It is too much to expect Mr Zander to outline a bold new plan for Motorola in his first week. But if he is to revive the firm he will have to get in touch with his inner visionary eventually. He has the skills to get Motorola's corporate engine firing on all cylinders, but then he will have to decide where the company should go.

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The other China

Parts that the bulldozers have not yet reached

Jan 8th 2004 | DALIAN, DAQING AND SHENYANG
From The Economist print edition

Imaginechina

Once the cradle of China's planned economy, the north-east is now a rustbelt. Reviving the region is one of the biggest challenges facing the leaders in Beijing

Get article background

THE urban China of gleaming office towers and brand new shopping malls is a world away from Ox Heart Village Alley. The lane of single-storey brick houses is just wide enough for bicycles, which weave to avoid laundry strung overhead and the detritus of an impoverished community—rusting metal buckets; a sofa covered in snow. Bitter winds blow down the alley, which lies in the industrial district of Shenyang, the capital of Liaoning Province in north-east China. Those lucky enough to have jobs struggle to work down the rutted, unpaved street.

Li Yuanshi, 75 years old, has lived in Ox Heart Village Alley since its houses were first built in the 1960s. “When Chairman Mao was alive, life was good,” she says. “It's not so good now.” Sitting in her tiny living room, where her bed also serves as a settee, she explains that her husband needs 800 yuan (about $96) a month to treat a wasting disease. After paying for heating, the couple's pensions leave them with only 150 yuan a month to live on.

Under Chairman Mao, medical expenses and heating bills were paid by the state-owned enterprise (SOE) or government department for which almost every urban resident worked. For as long as China's industries could bear such a massive welfare burden, Ms Li did not have to worry about her retirement.

Today, however, despite the striking impression of frenetic economic activity in many of China's big cities, poverty among urban residents is growing. In many places, life is even more harsh than it was under the old economic order. Government-owned enterprises are shedding their welfare roles, but the state is ill-equipped to take over. This leaves pensioners like Ms Li and the swelling ranks of the urban unemployed living from hand to mouth. Nowhere is this “other China” more conspicuous than in the north-eastern rustbelt—a microcosm of problems facing the whole country, and an area whose revival is a top priority for the new leadership in Beijing.

The frozen north

Embracing the three provinces of Heilongjiang, Jilin and Liaoning (see map), the north-east is home to 107m people, roughly equal to the populations of France and Spain combined. The three provinces are bounded by some of Asia's most backward economies—Mongolia, the Russian far east and North Korea—and their interior is a desolate landscape of idle factories and laid-off workers who stand along the roadside with placards advertising their skills strung around their necks. A foreign resident of Shenyang says that the closure of so many factories has at least improved the quality of the air. A few years ago, any settled snow quickly acquired a dusting of black grime.

Between 1997 and 2002, one-quarter of the 27m workers in state-owned enterprises who were laid off in China lived in the north-east. Although the region accounts for only 8% of the country's population, it accounts for 22% of city dwellers entitled to poverty relief. Even according to very conservative official figures, urban unemployment in Liaoning Province is 6.8%, which is well above what officials term the “danger line” of 5% and the national average of 4%. Using the broader definitions of unemployment that are used in other countries, the situation is far worse. Half of the labour force in Liaoning's mining cities, such as Fuxin (with a population of 1.5m) and Beipiao (630,000), are jobless.

It was not always so. The north-east is rich in natural resources and had a relatively well-developed industrial infrastructure when the area was wrested from Japanese control at the end of the second world war. After the Communist takeover in 1949 these assets persuaded the leaders in Beijing, with Soviet help, to develop many of the country's heavy industries there. This led to it being dubbed “the cradle of China's planned economy”.

The discovery of a vast oilfield in Daqing in the northernmost province of Heilongjiang in 1959 made the north-east an even greater treasure in the leadership's eyes. In 1980, the region's gross domestic product (GDP) was nearly 2.5 times that of Guangdong province in the far south, where the Pearl River delta is located. Heilongjiang produced half of China's petroleum, 40% of its timber and one-third of its heavy industrial machinery.

But the north-east's coal and oil reserves are dwindling fast, and the fact that the region is home to more large, state-owned industries than anywhere else in the country, once a blessing, is now a curse. With

incompetent (and often corrupt) management, outdated technology and machinery, and an army of workers and pensioners to be taken care of, most of China's once-proud SOEs are now making huge losses, kept alive only by a continual infusion of state funds. Although this problem exists throughout the country, nowhere is it as dire as in the north-east. Workers in SOEs there account for more than 73% of the industrial labour force.

Moreover, many of the north-east's SOEs are in sectors like steel, shipbuilding and machine tools in which the state has either been reluctant to cede ground to private or foreign capital, or in which non-state investors have shown little interest. Retarded by those industries' steady decline, the north-east's GDP had by last year fallen to slightly less than that of Guangdong, a province whose population is 30% smaller. For the north-east to join China's urban boom, it will have to tackle the problems of its state firms head on, rather than, as China's coastal regions have done, rely on the growth of new industries around them.

Concrete stirring stuff

The new guard in Beijing, under President Hu Jintao and Wen Jiabao, the prime minister, has made revitalising the “elder son of the republic”, as the region is fondly described, a top policy priority, not least to impress its communist credentials upon the party's conservatives. The region's cities are festooned with red banners proclaiming slogans that would have warmed even the heart of Chairman Mao: “Win the fortress-storming battle of reviving the old industrial base,” cries one ponderously on a Shenyang city flyover.

Even before he was formally appointed prime minister last March, Mr Wen paid a high-profile visit to the region, going down a coal mine in decaying Fuxin on the eve of the lunar New Year festival to eat dumplings with miners. And in August Mr Wen timed a visit to Daqing to coincide with the 80th anniversary of the birth of Wang Jinxi, one of the great icons of Chinese communism.

Mr Wang, who died in 1970 aged just 47, was known as the “Iron Man”. He was an oil worker who in the 1960s helped turn the desolate plain into China's biggest oil-production centre. One of his best-known exploits was jumping into a pit full of concrete to stir it with his body (as with many symbolic feats by China's communist heroes, a photographer was magically on hand to record the event). Mr Wang's heroism was once the stuff of endless propaganda aimed at inspiring workers in SOEs across the country.

There is little to inspire in Daqing now. Like the rest of the north-east, the city has been savagely cutting its state-enterprise payrolls. The urban workforce has shrunk by nearly 15% in the past five years. Crude-oil output, all of which belongs to the China National Petroleum Corporation, parent of PetroChina, is at its lowest for a quarter of a century, thanks to declining reserves. “I have affections for the Iron Man,” declared Mr Wen during his stay. But now Daqing and the rest of the region is wondering how, apart from professing his sympathies and indulging in public gestures, Mr Wen will help them.

So far, the government's plans are vague. On his visits, the prime minister called for “a new way of thinking” about the north-east's decline. He made it clear that Beijing was prepared to come up with investment and financial aid, and that there would also be new policies to attract foreign and domestic private capital and reduce the government's ownership of the region's enterprises. “This was an important policy decision that we had been looking forward to for a long time,” says Yu Fei, a Liaoning official responsible for economic planning.

The central government has yet to flesh out the details, however. Last autumn it issued a secret directive (known to insiders as “Document Number 11”) with some guidelines. Centrally financed infrastructure projects are likely to be part of the package: Shenyang, for example, should grow by 14% in 2004, not least due to a government-sponsored orgy of construction, including the building of northern China's tallest skyscraper. Even Ox Heart Village Alley will be no more in a few months' time. Shenyang is bulldozing its old industrial district to make way for a high-class residential area.

But this form of pump-priming is unlikely to play as critical a role as it has in the “Go West” programme which the government launched four years ago in an as-yet-unsuccessful attempt to help the country's backward western provinces catch up with the prospering coast. Whereas the west desperately needed new road and rail links to integrate it with the rest of the country, the north-east already has a semi-decent infrastructure.

In any case, such infrastructure spending often does little more than temporarily boost headline growth

rates. The area's wastefulness and lack of understanding of market demand is evident from the vast empty villa complexes built by private developers on the edge of Shenyang with loans from ignorant and corrupt state banks. Merely pumping money into the region has done nothing to change the fundamental problems of lack of competitiveness and bad management that beset the local industries.

Selling Off Elephants

So what can be done with the SOEs? Following a massive series of lay-offs and mergers over the past five years, provincial leaders are now hoping to address the biggest problem—ownership. Officials say they plan to sell off as many SOEs as they can. They want to keep a handful of the big, more profitable ones, but to expand non-state ownership even in these.

Xia Deren, the mayor of Dalian, a port city that has been relatively successful thanks to its proximity to Japan and the inflow of that country's foreign investment, laments the relatively low proportion of private business in the north-east and the scarcity of large-scale private enterprise. “In a real market economy, private business should be in a dominant position,” he says—a view that pushes the ideological envelope in a country still officially wedded to the oxymoronic notion of a “socialist market economy”.

Mr Xia admits that many people fear privatisation will increase unemployment and lead to social breakdown. In early 2002, thousands of oil workers in Daqing gathered in Iron Man Square to protest against unfair severance packages, while large protests broke out at about the same time in Liaoyang, south of Shenyang. But some Chinese leaders do understand that allowing the SOEs to stick to their old ways and sink further into loss could drag the economy down with them. In Dalian, officials say they plan to sell off the state's majority shareholdings in the city's 20 or so listed companies within two years. Harder to believe is their claim that the state will loosen its grip, retaining a stake in only a handful of the largest ones, but not necessarily a controlling one.

Selling state enterprises will be a colossal challenge. Cut off from state aid, many would be unviable without a wholesale upgrade of their capital stock and technology—something that few domestic private investors have the resources to undertake. Worries about the cost and difficulty of firing workers further deter potential investors, both domestic and foreign.

Wish you weren't here?

Rather than bracing themselves for sale, takeover or closure, the bigger state-owned enterprises in the region are pinning their hopes on bail-outs. Provincial officials reckon that the debts of some of the enterprises are to be written off. According to the official media, the central government has approved an initial 100 “important projects” in the north-east, the refinancing of which will cost 61 billion yuan ($7.3 billion). The money is to come in the form of low-interest loans from state-owned banks, supplemented by capital from foreign investors and other sources.

More than half of the projects and 73% of the investment will go to Liaoning, the biggest province. The projects consist mainly of upgrading SOEs in sectors like equipment manufacturing, raw-materials production and food processing. But Liaoning's big steel and shipbuilding plants will also benefit.

All this has the air of another government-ordained initiative. Launched after scarcely any consultation with private or foreign businesses, it shies away from the most difficult and badly needed reforms. SOEs have little chance of becoming competitive if they continue to be drip-fed with loans from state-owned banks that they have scant chance of repaying. The ratio of non-performing loans at north-eastern bank branches is the highest in the country, which is itself so overwhelmed with bad debts that the big state-owned banks need regular injections of capital in order to avoid insolvency.

Another danger is that government aid will do less to revive the fortunes of ailing enterprises than to line the pockets of local officials. The north-east is notorious for corruption. In 2001, the mayor and deputy mayor of Shenyang were sentenced (one of them to death) for their involvement in a mafia-like ring. The city was also the home of Yang Bin, a horticulturist whose fortune (earned elsewhere) briefly made him China's richest man before he was arrested for corruption. Last month, a deputy governor of Liaoning was sacked for taking bribes while a top Communist Party official in Jilin was dismissed in October for the same reason.

By publicising such high-level cases, the authorities hope to curb the problem and assuage public anger. But there is little sign that corruption is abating. Any future privatisation is likely to involve an upsurge of asset-stripping that will inflame public sentiment further and make the region even more unstable.

Despite the potential pitfalls, however, some foreign investors are venturing into the area. In March 2003, BMW, a German carmaker, established a *euro*150m ($160m) joint venture with Brilliance, a state-controlled company in Shenyang, to produce saloon cars. Volkswagen has a 50% stake in a substantial carmaking joint-venture in Jilin with First Automobile Works, a large SOE. With China's car market booming, foreign manufacturers are falling over themselves to invest in the country. As a traditional car centre, the north-east has some advantages, including labour costs that are lower than those of the more developed coastal region to the south.

Proximity to its home base and a decent supply of skilled labour have persuaded LG, a South Korean consumer-electronics manufacturer, to set up a research and development centre in its Shenyang factory that it hopes will become its global R&D base. Some see opportunities in the service sector too. Wal-Mart opened a second superstore in Shenyang last month. The American retail colossus also has stores in the north-east's other provincial capitals as well as in Dalian.

But this investment is still relatively small stuff. The region has been unable to match the success of the Yangtze and Pearl River deltas in attracting investment in low-technology, labour-intensive private industry. Cold, polluted and far from big markets, the once vibrant region attracted just $4 billion of China's total of $52.7 billion of foreign direct investment in 2002, less than the city of Shanghai, which has a seventh of the population and less than half the GDP. It is hard to see foreign companies risking the outright takeover of an SOE in the region. LG even refuses to take on their laid-off workers, preferring to train all its employees from scratch.

Chinese officials argue that reviving the north-east is essential if the government is to achieve its target of quadrupling 2000's GDP by 2020. But the north-east's revival has little to do with the country's overall economic-growth targets. There is no sign that the Yangtze or Pearl River deltas, or the Beijing-Tianjin corridor further north, are running out of steam. Indeed, their dynamism is spreading ever farther inland.

The new emphasis on the north-east has much more to do with the political necessity of combating wealth disparities within China. Ensuring that there are more even rates of growth across the country has become the mantra of a new leadership that wants to strengthen its legitimacy by appearing to be in sympathy with those who live in the other China.

But this carries with it a huge political risk. If badly done, the country's inequalities will become ever more apparent, threatening social order. Worse, if it works and capitalism gains traction even in the backward north-east, locals might question the need for such an overweening central government. Either way, the Communist Party's grip on power could then come under threat.

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The euro

Flying high

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From The Economist print edition

Should the ECB try to bring down the rising euro by cutting interest rates?

Get article background

AFTER celebrating its fifth birthday on January 1st, the euro hit another new high against the dollar this week, above $1.28. That is almost 10% more than it bought in June 2003, when the European Central Bank (ECB) last cut interest rates, and over 50% above its low in 2001. A stronger currency will squeeze growth and inflation, just like a tightening of monetary policy—a reason, you might think, to cut interest rates. Yet the ECB held rates unchanged at its meeting this week. Indeed, most economists still expect that the next move in rates will be up, not down: the futures market is betting that rates will rise from 2% now to 2.6% by December.

Is the ECB right to shrug off the euro's climb? The central bank needs to worry about the strength of the euro only to the extent that it affects inflation. Consumer-price inflation in the euro area was 2.1% in December, still slightly above the ECB's objective of “less than but close to 2%”. A rising euro will reduce import prices and so push inflation lower, but the impact so far has been fairly modest.

One reason is that although the euro has risen sharply against the dollar, in trade-weighted terms—ie, against a basket of the main currencies—its rise has been more modest, only 3% since June and 25% since 2001. That merely reverses its previous decline, taking its trade-weighted rate to the same level as at its launch five years ago. Indeed, it is also currently almost exactly at its average level over the past 20 years, using an index of its predecessor currencies before 1999 (see chart).

A second factor, according to economists at J.P. Morgan, is that the impact of a stronger euro on inflation may be more muted than in the past. The rise in the euro since 2001 has left core inflation (ie, excluding energy and food prices) virtually unchanged. This may be because exporters to the single-currency zone are now more inclined to keep their prices fixed in euro terms, so that the rising euro fattens their profit margins, than to let their prices fall and see their market share increase. If so, a rise in the euro will have a smaller effect on inflation than if exporters adjusted prices. That said, there

will still be some impact. Thanks to the currency's strength, commodity import prices in the euro area fell by 5% in the year to December.

David Walton, an economist at Goldman Sachs, argues that a stronger euro may cause the ECB to delay raising interest rates, but is unlikely to trigger a rate cut unless the currency continues to soar and there is evidence that it is seriously hurting the economy. But the euro is quite likely to climb higher. Economists at HSBC reckon that the dollar needs to fall by another 20% in trade-weighted terms to make a significant dent in America's current-account deficit. If China and other Asian economies continue to resist appreciation in their currencies, then that could imply a euro rate of more than $1.60.

Roses and thorns

Nevertheless, despite the recent rise in its currency, the euro area is widely tipped to enjoy an economic recovery in 2004. *The Economist*'s latest poll of forecasters points to GDP growth of 1.9% this year, up from 0.5% in 2003. This would be the zone's strongest growth rate for four years—albeit less than half the rate expected for America. However, that consensus figure conceals a fairly wide range of forecasts. The optimists expect growth to rebound to 2.5%, believing that a strong global recovery will offset some of Europe's loss of competitiveness, and that consumer spending will pick up as lower inflation and income-tax cuts in Germany and France boost households' purchasing power. Goldman Sachs expects most of the euro area's economic slack to be absorbed by the end of this year, so inflation is unlikely to fall by much. It expects the ECB to raise interest rates to 2.75% by the end of the year.

Economists at HSBC take a different view. They expect the euro area's GDP to grow by a more modest 1.7% in 2004. They think domestic demand will stay relatively weak as business investment is held back by high corporate debts. If so, a strong euro will cause overall GDP growth to slip back below trend in the second half of 2004. As a result, HSBC forecasts that inflation will fall to 1.5% in 2004 and around 1% in early 2005. (In contrast, the ECB's forecast of 1.8% inflation in 2004 assumes an exchange rate of only $1.17.) HSBC therefore expects a further cut in interest rates, to 1.5% by late 2004.

A rising currency could be beneficial for the euro area if it helps to hold down inflation and boost consumers' spending power; it could also encourage structural reforms. However, a rising euro will certainly complicate monetary policy. Cutting interest rates to dampen the euro and support recovery would risk fuelling the growth of liquidity. The recent rapid pace of growth in the money supply is already causing the ECB concern. An interest-rate cut and faster expansion of domestic credit would put upward pressure on inflation expectations and could pump up asset prices. On the other hand, a rise in interest rates would risk pushing the euro even higher, thus aborting recovery.

One alternative solution to cutting interest rates is foreign-exchange intervention. Before the ECB considers a rate cut it is more likely first to try to talk down the currency and then to sell euros and buy dollars to slow the pace of appreciation.

Such currency intervention would signal that the euro was no longer a one-way bet. In 2000, when the euro's value was tumbling towards 80 cents, the ECB and other central banks stopped its fall by selling dollars and buying euros. Today, however, the ECB is unlikely to win the support of the American Treasury, which seems happy to allow a weaker dollar to support American manufacturing industries.

Exchange rates will be high on the agenda at a gathering of G7 finance ministers and central bankers in Florida on February 6th. An innocuously worded statement at the previous meeting, in Dubai last September, began the dollar's slide. This time European policymakers are likely to put pressure on Japan to bear its fair share of the dollar's decline and to stop its heavy intervention—around $190 billion last year—to hold the yen down. If the Europeans fail in that, they may well join the Japanese, and start intervening themselves.

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About sponsorship

The New York Stock Exchange

Mr Thain moves in

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From The Economist print edition

A rescue squad begins work at America's leading stock exchange

THE job of running the New York Stock Exchange (NYSE) has at times been a virtual sinecure. At others, it has involved a desperate scramble to forestall disaster. With the NYSE facing technological obsolescence, several investigations and litigation on a grand scale, and with its reputation in shreds, there is little question about what kind of job it is at the moment. Undaunted, on January 15th John Thain will leave one of Manhattan's smartest addresses, the unmarked headquarters of Goldman Sachs at 85 Broad Street, for the chief executive's suite at the NYSE, a few hundred yards down the road.

Hiring Mr Thain, Goldman's second most-important executive, is something of a coup. Few have a curriculum vitae as impressive as his. Although Mr Thain's pay at the NYSE, $4m a year, will be no pittance, he earned twice as much at Goldman in 2002 and his current contract there could, in an excellent year, have bagged him $35m. By Wall Street's standards, his move to the NYSE counts as philanthropy—the more so, because his new job looks like a managerial nightmare.

At Goldman, as at most companies, the people on top can exercise control in the usual ways: by hiring, firing, promoting and setting pay. At the NYSE, the chief executive controls only a small component of operations. The main business is in the hands of brokers, “specialist” firms (which execute trades) and listed companies. Some of these are not only served by the exchange but also compete with it. Richard Grasso, who resigned as chairman and chief executive in September, managed this unwieldy conglomeration by a number of means, including intimidation. Mr Thain will have less power. Under a new structure he will not have authority over regulation. In any case he will no doubt want to set a higher ethical standard.

His prospects would be grim were it not for the growing sense among the NYSE's self-interested factions that they have a great incentive to ensure his success. Under John Reed, who took over temporarily as chief executive after Mr Grasso quit, a broad restructuring has been designed and accepted by the NYSE's members and the Securities and Exchange Commission (SEC). In less pressing circumstances this might have taken years or even have been derailed. Efforts are under way to bring in a chairman and a head of regulation who will be more than figureheads. The top choice for chairman is said to be Sir Dennis Weatherstone, a Briton who headed J.P. Morgan when it was the world's most esteemed bank. For regulation, it is Richard Ketchum, a respected former regulator who not long ago was hired by Citigroup to restore its frayed standing. As *The Economist* went to press, Mr Ketchum was thought likely to sign up.

The exchange faces an unpleasant few weeks. Soon it will release the details of a report prepared by a former prosecutor, Daniel Webb, showing how Mr Grasso walked all over a supine board packed with the great and good. He enriched himself, but in the process made a mockery of the NYSE's reputation. The SEC is racing to complete its investigation into specialists, thus producing more critical headlines.

Yet all this may have more to say about the exchange's past than about its future. The price of a trader's seat on the exchange, though well below its peak, may have stabilised since Mr Grasso left (see chart). Shares in LaBranche, the only pure play on a specialist firm, have risen by almost half since early December. They spiked in the run-up to Mr Thain's appointment. Even if this smells of insider trading, it also has a scent of optimism. Mr Thain has no illusions about the importance of restoring investors' confidence and ensuring that the NYSE provides the most liquid and efficient market in the world. A decade ago, its ability to do

this was unchallenged. Not now. Mr Thain is acutely aware of the competitive challenges. Goldman, among others, invested in systems designed to bypass the exchange. And the rival, electronic NASDAQ stock exchange is said to be planning to encourage NYSE-listed companies to be listed on NASDAQ too .

Even with the growth in alternative markets, however, the NYSE continues to handle the largest share of Goldman's business. That, and his willingness to take the job, suggest Mr Thain must believe the exchange has a future. His new position will require a tenure of at least three years. If he is successful, whoever follows him will have much to thank him for.

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About sponsorship

Recapitalising China's banks

Botox shot

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From The Economist print edition

Injections of capital may soon wear off

TO THE devotees of Sun Tzu's “Art of War” who govern in Beijing it must have seemed an irresistible stratagem. On the one hand, years of poor lending have created a vast hole in the balance sheets of China's banks, putting the country's rapid economic growth at risk. On the other, China has amassed a mountain of foreign-exchange reserves—evidence, say many, especially in America, of an unfairly undervalued currency. So why not shovel some of the latter into the former and silence the critics on both fronts?

On January 6th it emerged that at the end of last year, China had secretly done just that. It had injected $45 billion, or just over a tenth of its foreign-currency reserves, into two of its big four state-owned banks, China Construction Bank (CCB) and Bank of China (BOC).

While rumours of a bank bail-out have been building, Beijing's imaginative use of its reserves was a surprise. Most bank recapitalisations involve an injection of government bonds or domestic funds by the central bank. But China's scheme is quick and effective, points out Jonathan Anderson, chief economist at UBS in Hong Kong, because it does not require prior approval from the legislature and does not increase government debt.

By favouring the best (or least bad) two of China's four biggest banks, the authorities are starting at the manageable end of the problem. They are also dangling a carrot in front of the others: refreshed by their new funds, CCB and BOC are expected to list their shares on the stockmarket, both at home and in Hong Kong, at the end of this year or early next. If Industrial and Commercial Bank of China and Agricultural Bank, the two laggards, shape up, they too may get permission to do so. And despite their questionable quality, Chinese initial public offerings are currently the hottest investments around.

The elegance of the scheme does not end there. Exchanging $45 billion for yuan would increase the upward pressure on the Chinese currency, which is already straining against its dollar peg. Therefore the money is being left in dollars—indeed, in American treasuries—and will be managed by a government holding company.

This leads to the final part of the design. Rather than writing off non-performing loans with the fresh funds, the two banks will use them to boost their capital-adequacy ratios and thus to support new, supposedly more profitable, lending. Thus the government is not bailing them out directly, but intends to buy them time to grow out of their bad-debt problem.

This smacks of unjustified optimism. While the government deserves credit for taking action, its track record is not good. Previous capital injections and write-offs, totalling 1.67 trillion yuan ($200 billion) since 1998, have worn off like a botox shot. Behind a smoother-looking balance sheet, wasteful, politically directed lending to dud state-owned enterprises continued. There is little reason to believe that tomorrow's loans will turn out better.

As recently as November, Liu Mingkang, the top banking regulator, promised there would be no new funds and certainly no listings without corporate-governance and management reforms first. Now it appears that CCB and BOC have been granted both, in return for nothing more than unspecified, but probably low, interest payments on the $45 billion. As Andy Xie of Morgan Stanley argues: “The problem is not capital. The problem is that China's banks are still not real banks. They are tools of the Communist Party.”

Perhaps they are now even riskier tools. With a large slug of their capital denominated in dollars and

their loans still in yuan, the two pioneers would be exposed if the yuan were revalued, says Desmond Supple of Barclays Capital. “If this is the blueprint for future recapitalisations,” he points out, “it means greater sensitivity of the banks to exchange-rate risk.” More important, the bail-out is too small. Even official estimates put the bad loans of the big four at $290 billion. Independent analysts think the true figure is closer to $420 billion. A durable solution that can attract overseas investors, especially strategic partners, will require greater sums. Unless more treatment follows, the wrinkles will soon reappear on China's banks.

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About sponsorship

Credit cards in South Korea

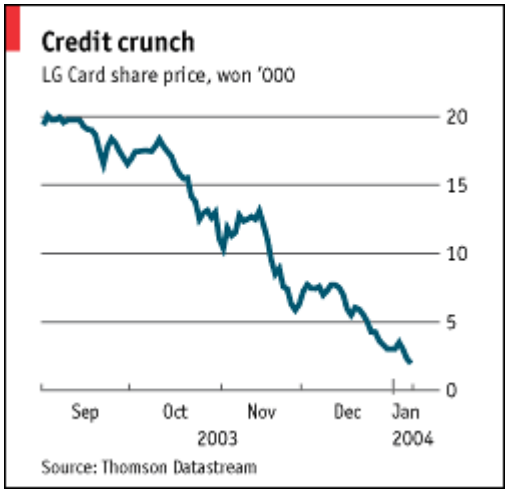
Snap!

Jan 8th 2004
From The Economist print edition

The consequences of South Koreans' credit-fuelled spending spree

THE last time South Korean lenders were in serious trouble, the cause was the fecklessness of the *chaebol,* the country's big, family-owned conglomerates. Now many suppliers of finance have let themselves be undermined by an army of over-enthusiastic shoppers. This week, creditors of the country's biggest credit-card issuer, LG Card, continued to lock horns with the state-run Korea Development Bank (KDB) over the terms of a proposed bail-out. On January 5th they rejected KDB's offer to inject 5.15 trillion won ($4.3 billion) into LG Card in return for a 19% stake and urged the state-run bank to put in more money and to take a larger share in the card company.

By January 8th, no solution had been reached. On that day LG Card was so short of money that it was forced to refuse some cash advances to cardholders. Its share price fell by 15%, the maximum allowed on the Seoul stock exchange, for the fourth day running.



The creditors—which only two months ago injected 2 trillion won into LG Card—were arguing among themselves over a slightly more generous offer from KDB. LG Card's biggest creditor, Woori Financial Group, was threatening to take the card issuer into receivership if minority creditors did not accept it. Whether or not there is a bail-out, there is a broader question hanging over the economy: to what extent will the consumer-credit collapse erode the gains South Korea has made since the financial crisis of 1997-98?

The country's rapid embrace of credit cards was a deliberate reaction to that crisis, which had exposed both South Korea's over-reliance on exports and the extent of reckless corporate borrowing, especially by the *chaebol*. After the government recapitalised the banks, it made sense for these to shift more of their lending towards consumers. This complemented the government's aim of promoting more domestic consumption, especially of fast-growing sectors related to mobile telecoms, internet use and entertainment. The state, indeed, encouraged credit-card borrowing by giving tax breaks to shoppers who made lots of purchases with plastic.

It was not long before consumers got carried away. By last year the average South Korean consumer was carrying four credit cards, and was eagerly putting them to use. Regulators forced issuers to adopt more stringent criteria, but by then it was too late. Many borrowers were already using cash advances from one card to make payments on another. In November, borrowers from South Korea's eight credit-card issuers were more than a month overdue on 13.5% of their debts.

When the credit-card craze finally began to abate, consumer spending slowed too. The government estimates that real GDP grew by less than 3% last year, in an economy geared for a rate of 5-6%. Consumers will probably have to get their finances in order before domestic consumption can rebound.

LG Card may yet be bailed out within the next few days. But however the credit-card company's troubles are resolved, the financial health of all those plastic-loving consumers will continue to be an important gauge of the strength of the South Korean economy.

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BCCI

Old wounds

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A dispute over a bank failure finally comes to court

FOR many, the new year is a time to look forward. Not for the Bank of England. On January 12th Britain's central bank will be in court, defending its record as the regulator of the Bank of Credit and Commerce International (BCCI), a fraud-ridden bank that collapsed in 1991 leaving depositors across the world $10 billion poorer. The plaintiff is Deloitte & Touche, the bank's liquidator, representing 6,500 depositors in Britain. It claims that the Bank "knowingly or recklessly" failed to supervise BCCI properly in the 12 years before BCCI imploded, and is seeking £850m ($1.5 billion) in damages.

The case has come to court only after 11 years of legal tussling between the Bank and Deloitte. British newspapers are already relishing the thought that three former governors of the Bank, as well as other officials, might have to give evidence. Excerpts from 300,000 Bank documents, released to Deloitte on court orders, are expected to be aired.

Deloitte's task is not straightforward. The Bank is statutorily immune from suits based on negligence. So the case against it is of "misfeasance" in public office, a rare allegation that legal experts say is hard to establish. Deloitte's lawyers must show not just that the Bank acted unlawfully, but that it did so deliberately or recklessly, knowing that its decisions would cause loss to depositors. "The legal hurdles to success are very high," says a senior partner of a leading British law firm.

Deloitte, however, sets great store by the trove of documents released by the Bank and others, some of which were not seen by the inquiry by Lord Bingham (now Britain's senior law lord) into the BCCI affair in the early 1990s. It thinks that these demonstrate that the Bank acted in bad faith. The Bank, it says, licensed BCCI to do business in Britain in 1979, even though it knew BCCI did not meet the proper criteria. Deloitte also says that the Bank did not regulate BCCI adequately in subsequent years, despite evidence that shady dealings were afoot.

BCCI was founded in Pakistan by Aga Hassan Abedi, a savvy financier with a vision of creating a world-class retail bank focused on the developing world. It set up shop in London in 1972, catering for immigrants from South Asia. Backed by the ruling family of Abu Dhabi and Bank of America (which owned a 25% stake), and flush with petrodollars from newly rich Middle Eastern investors after the oil embargo in 1973, BCCI grew rapidly. By 1979 it had 45 branches in Britain alone; by 1982 it had 280 in 57 countries.

But some people became worried that BCCI's growth came with big risks. Bank of America, which had upped its stake to 45% in 1977, began selling its shares soon thereafter, having become concerned about imprudent lending. Bank documents show that some Bank of England officials were troubled by BCCI's over-reliance on Mr Abedi (an "essentially slippery customer", according to one memo) and by its risky lending. But the Bank licensed BCCI anyway, relying on assurances from authorities in Luxembourg, where BCCI had been incorporated in 1972.

Indeed, a critical piece of Deloitte's case is that the Bank consistently shirked its duty to supervise BCCI by claiming that it was a Luxembourg bank, even though London was its "operational headquarters and administrative nerve centre", according to another internal memo. Deloitte points to memoranda showing that the Bank maintained this line even after the authorities in Luxembourg themselves told the Bank that they could not properly oversee BCCI, and even as evidence mounted that BCCI was, in the words of one Bank employee, "the financial equivalent of the *SS Titanic*". Deloitte believes it can show that the Bank faced up to BCCI's sorry state and acted to close the bank only when American authorities threatened to indict BCCI's auditor, Price Waterhouse.

The Bank of England admits that it made mistakes over BCCI. But were its decisions truly dishonest, or merely poor? The Bank says that the reams of documents voicing concerns over BCCI's financial condition prove not misfeasance, but the Bank's open process and seriousness of purpose.

Furthermore, the Bank argues, dealing with BCCI was no simple matter. By 1988, it had 1.3m depositors worldwide and $15.7 billion in deposits. Whatever course of action the Bank might have chosen entailed considerable risks. Revoking BCCI's licence would have meant shutting it down, in effect. Taking on a lead supervisory role would have made the Bank liable for BCCI's sprawling, murky operations from Colombia to Botswana.

So far, the liquidators have clawed back $7.8 billion of the money lost by depositors through lawsuits against BCCI's auditors and the government of Abu Dhabi, although at a cost of $1 billion. Success in this case would mean recouping a large chunk of the remainder, at a price: lawyers' fees on the two sides are expected to run as high as £100m. Whatever the outcome, though, the case looks likely to make bank supervision look a lot less dreary than usual. Win or lose, this is excitement the Bank of England could do without.

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Economics focus

Sumo cum laude

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You have to respect a research programme that extends from Japanese wrestling to "The Weakest Link"

EVERY two years the American Economic Association (AEA) awards the John Bates Clark medal to the economist under 40 who has made the greatest contribution to the discipline. Paul Krugman, the Princeton professor, *New York Times* columnist, and Clark medallist in 1991, has rightly, if immodestly, pointed out that this award says more about the winner's excellence as an economist than does the better known, but rather less exclusive, Nobel prize. That honour, after all, is sprayed out every single year, often to more than one winner, and decades after the laureates have done their best work. Look to the Clark medal to see who is really at the top of the field, here and now.

At the AEA's annual meeting in San Diego this week, the award was given to Steven Levitt, of the University of Chicago. Mr Levitt is a worthy and unusually interesting winner. He has distinguished himself not with fancy theory or one or two particularly important breakthroughs, but with a series of remarkably wide-ranging and ingenious empirical investigations.

It is clear from Mr Levitt's research that he practises his discipline not as an end in itself but because he is interested in the world. Also, if he does not actually relish a politically incorrect finding, he certainly never shies away from one. Sadly, both traits set him apart.

Publish and be damned

If you browse through the working papers circulated by the National Bureau of Economic Research (at www.nber.org) you will find that in 2003 alone Mr Levitt wrote or co-wrote seven. His topics included the effect of school choice on educational results; the causes and consequences of distinctively black names; the effect of legalised abortion on crime; how to test theories of discrimination using evidence from the television programme, "The Weakest Link"; the gap in test results between blacks and whites in the first two years of schooling; gambling and the National Football League; and teachers who cheat in appraisals of their students' performance. Among the work he has published in prestigious peer-reviewed journals are a series of papers on crime and punishment, drug-gang finance, penalty kicks in soccer, money and elections, drunken driving, and the effect of ideology as opposed to voter preferences on the policies supported by politicians. In 2002 the impeccably sober *American Economic Review* published a paper co-written by Mr Levitt on corruption and sumo wrestling. You get the idea.

There is always a serious point—usually about empirical methodology—even in Mr Levitt's seemingly frivolous projects. The paper on sumo wrestling is interesting not just for its persuasive demonstration that contests are often rigged, but also for the way Mr Levitt and his co-author, Mark Duggan, set about showing this. The incentive structure in the sport means that wrestlers on the margin of achieving a winning record have far more to gain from winning than opponents, not on the margin, stand to lose if defeated. That opens the window to corruption. Wrestlers on the margin duly win more often than their record would lead you to expect—and the authors show that increased effort cannot be the explanation. Also, wrestlers who win under these conditions lose more than they should when they later face the same opponents, suggesting "repayment in kind". At times of intense media scrutiny, evidence of fixing disappears. The research is instructive for economists sceptical that clear-cut evidence of corruption can ever be found. Imaginative prospecting for data, together with great ingenuity in drawing warranted inferences from them—the Levitt hallmarks—can reveal far more than you might suppose.

Mr Levitt's research on crime has earned him occasional spells of petty notoriety in the wider world. The

paper on legalised abortion and crime is a case in point. Mr Levitt, along with co-author John Donahue, boldly surmised that legalised abortion might have reduced the number of unwanted children born to parents likely to raise criminal offspring. The evidence, as it turned out, strongly supported that guess. The states that first allowed legal abortion in 1970 (three years before *Roe v Wade*) were the first to experience the subsequent downturn in crime; states with high abortion rates experienced bigger reductions in crime. The data are tested this way and that, and the conclusion stands up. The authors reckon that legalised abortion may account for half of the fall in crime of the 1990s.

Mr Levitt has also ruffled some feathers with his work on imprisonment. A chief finding is that prison works. It reduces crime, and not just because it keeps people who would otherwise be committing crimes off the streets. It also deters, something which many right-thinking people wish not to believe. Technically speaking, a big challenge in this area of research was to deal with a classic instance of the so-called simultaneity problem: incarceration rates affect crime rates, but the converse is also true. Disentangling the two relationships is impossible unless a third variable with the right statistical properties, a so-called instrument, can be found and exploited.

In one strand of investigation, Mr Levitt used prison-overcrowding litigation—an improbable but statistically effective instrument—to do the job. Properly analysed, the data then show that reducing the prison population by one (saving roughly $30,000 a year) increases the number of crimes committed by 15 a year (costing roughly $45,000 a year). In separate work, equally unpalatable to many people, Mr Levitt shows that juveniles respond to the disincentive effects of punishment in much the same way that adults do. Kinder regimes, in other words, promote juvenile crime.

Despite such provocative and uncomfortable findings, few if any of Mr Levitt's peers will deny he deserves the Clark medal. That may say as much as the award itself.

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Linguistics

Babel's children

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Corbis

Languages may be more different from each other than is currently supposed. That may affect the way people think

IT IS hard to conceive of a language without nouns or verbs. But that is just what Riau Indonesian is, according to David Gil, a researcher at the Max Planck Institute for Evolutionary Anthropology, in Leipzig. Dr Gil has been studying Riau for the past 12 years. Initially, he says, he struggled with the language, despite being fluent in standard Indonesian. However, a breakthrough came when he realised that what he had been thinking of as different parts of speech were, in fact, grammatically the same. For example, the phrase “the chicken is eating” translates into colloquial Riau as “ayam makan”. Literally, this is “chicken eat”. But the same pair of words also have meanings as diverse as “the chicken is making somebody eat”, or “somebody is eating where the chicken is”. There are, he says, no modifiers that distinguish the tenses of verbs. Nor are there modifiers for nouns that distinguish the definite from the indefinite (“the”, as opposed to “a”). Indeed, there are no features in Riau Indonesian that distinguish nouns from verbs. These categories, he says, are imposed because the languages that western linguists are familiar with have them.

This sort of observation flies in the face of conventional wisdom about what language is. Most linguists are influenced by the work of Noam Chomsky—in particular, his theory of “deep grammar”. According to Dr Chomsky, people are born with a sort of linguistic template in their brains. This is a set of rules that allows children to learn a language quickly, but also imposes constraints and structure on what is learnt. Evidence in support of this theory includes the tendency of children to make systematic mistakes which indicate a tendency to impose rules on what turn out to be grammatical exceptions (eg, “I dided it” instead of “I did it”). There is also the ability of the children of migrant workers to invent new languages known as creoles out of the grammatically incoherent pidgin spoken by their parents. Exactly what the deep grammar consists of is still not clear, but a basic distinction between nouns and verbs would probably be one of its minimum requirements.

Plumbing the grammatical depths

Dr Gil contends, however, that there is a risk of unconscious bias leading to the conclusion that a particular sort of grammar exists in an unfamiliar language. That is because it is easier for linguists to discover extra features in foreign languages—for example tones that change the meaning of words,

which are common in Indonesian but do not exist in European languages—than to realise that elements which are taken for granted in a linguist's native language may be absent from another. Despite the best intentions, he says, there is a tendency to fit languages into a mould. And since most linguists are westerners, that mould is usually an Indo-European language from the West.

It need not, however, be a modern language. Dr Gil's point about bias is well illustrated by the history of the study of the world's most widely spoken tongue. Many of the people who developed modern linguistics had had an education in Latin and Greek. As a consequence, English was often described until well into the 20th century as having six different noun cases, because Latin has six. (A noun case is how that noun's grammatical use is distinguished, for example as a subject or as an object.) Only relatively recently did grammarians begin a debate over noun cases in English. Some now contend that it does not have noun cases at all, others that it has two (one for the possessive, the other for everything else) while still others maintain that there are three or four cases. These would include the nominative (for the subject of a sentence), the accusative (for its object) and the genitive (to indicate possession).

The difficulty is compounded if a linguist is not fluent in the language he is studying. The process of linguistic fieldwork is a painstaking one, fraught with pitfalls. Its mainstay is the use of “informants” who tell linguists, in interviews and on paper, about their language. Unfortunately, these informants tend to be better-educated than their fellows, and are often fluent in more than one language. This, in conjunction with the comparatively formal setting of an interview (even if it is done in as basic a location as possible), can systematically distort the results. While such interviews are an unavoidable, and essential, part of the process, Dr Gil has also resorted to various ruses in his attempts to elicit linguistic information. In one of them, he would sit by the ferry terminal on Batam, an Indonesian island near Singapore, with sketches of fish doing different things. He then struck up conversations with shoeshine boys hanging around the dock, hoping that the boys would describe what the fish were doing in a relaxed, colloquial manner.

The experiment, though, was not entirely successful: when the boys realised his intention, they began to speak more formally. This experience, says Dr Gil, illustrates the difficulties of collecting authentic information about the ways in which people speak. But those differences, whether or not they reflect the absence of a Chomskian deep grammar, might be relevant not just to language, but to the very way in which people think.

Word, words, words

A project that Dr Gil is just beginning in Indonesia, in collaboration with Lera Boroditsky, a researcher at the Massachusetts Institute of Technology, is examining correlations between the way concepts are expressed in languages and how native speakers of these languages think. This is a test of a hypothesis first made by Benjamin Lee Whorf, an early 20th-century American linguist, that the structure of language affects the way people think. Though Whorf's hypothesis fell into disfavour half a century ago, it is now undergoing something of a revival.

Dr Boroditsky's experiment is simple. People are shown three pictures, one of a man about to kick a ball, one of the same man having just kicked a ball, and a third of a different man who is about to kick a ball. They are then asked which two of the three are the most similar. Indonesians generally choose the first two pictures, which have the same man in them, while English speakers are likely to identify the two pictures that show the ball about to be kicked—an emphasis on the temporal, rather than the spatial, relationship between the principal objects in the picture.

Dr Gil believes that this might be because time is, in English, an integral grammatical concept—every verb must have a tense, be it past, present or future. By contrast, in Indonesian, expressing a verb's tense is optional, and not always done. In support of Whorf's idea, Dr Gil half-jokingly cites the fact that Indonesians always seem to be running late. But there is more systematic evidence, too. For example, native Indonesian speakers who also speak English fall between the two groups of monoglots in the experiment. Dr Gil supposes that their thought processes are influenced by their knowledge of both English and Indonesian grammar.

Demonstrating any sort of causal link would, nevertheless, be hard. Indeed, the first challenge the researchers must surmount if they are to prove Whorf correct is to show that English and Indonesian speakers do, in fact, think differently about time, and are not answering questions in different ways for some other reason. If that does prove to be the case, says Dr Gil, their remains the thorny question of whether it is the differences in language of the two groups that influences their conception of time, or

vice versa.

Dr Boroditsky and Dr Gil are not intending to restrict their study to ideas about time. They plan, for example, to study gender. English, unlike many other languages, does not assign genders to most nouns. Does this affect the way English-speakers think of gender? Languages also differ in the ways they distinguish between singular and plural nouns. Indeed, some do not distinguish at all, while others have a special case, called the dual, that refers only to a pair of something. Descriptions of spatial relations, too, vary, with languages dividing the world up differently by using different sorts of prepositions. The notion that grammar might affect the way people think may seem far-fetched, and even unappealing to those who are confident of their own free will. But if Dr Gil is right and there do exist languages, like Riau Indonesian, without nouns or verbs, the difficulty of conceiving just that fact points out how much grammar itself shapes at least some thoughts.

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NASA spacecraft

Jan 8th 2004
From The Economist print edition

Get article background

Two successes for NASA, America's space agency. On January 2nd, its *Stardust* probe flew to within 240km (150 miles) of comet Wild 2 and collected samples from the comet's dusty coma. Probe and samples will, if all goes well, return to Earth in 2006. Meanwhile, on January 4th, the agency's Mars rover *Spirit* bounced down safely and began broadcasting pictures of the planet's surface. Still no word though (at least, as *The Economist* went to press) from the British Mars probe *Beagle 2*.

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SARS

Here we go again?

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From The Economist print edition

A new case of the respiratory disease SARS is not the end of the world

Get article background

WHEN the Chinese New Year arrives later this month, one thing is certain: it will not be known as the year of the palm civet. By January 11th, health officials in Guangzhou expect to have completed their “patriotic” extermination of thousands of representatives of the species from wild-animal markets in and around the city. The cull, and the closure of the markets, is China's response to a single, seemingly isolated, case of SARS—a respiratory disease that caused panic as it spread around the world in the first half of 2003. The victim, who lived in a suburb of Guangzhou and who went into hospital in December, has since made a full recovery.

This is the first case of SARS outside a research laboratory since the disease was declared contained in July 2003. During the first SARS outbreak, the Chinese authorities tried, at first, to cover the epidemic up. This disastrous course of action allowed the virus to take hold, and it subsequently spread to 30 countries. According to the World Health Organisation (WHO), 774 people died. So feverish activity in response to this case might seem a good thing. And since palm civets have been identified as a possible source of the SARS virus, a cull looks, on the face of things, like a good idea.

But the trouble is that nobody knows if it will actually do any good. For one thing, it is unclear how the patient caught SARS. He had not, apparently, eaten any wild animals in the month before he fell ill, and does not appear to have had any contact with palm civets. By some accounts, he has had more contact with rats, which he had been catching in his apartment.

One reason for the cull might be reports that genetic material from the patient's virus appeared to be related to a SARS-like virus found in civets. But according to the WHO, only one of the many samples taken from the patient was positive. This raises the question of whether it was contaminated by accident.

During the initial outbreak, SARS-like viruses were found in several species besides palm civets. Nevertheless, no “animal reservoir” of the virus has been demonstrated for certain, so it is not known where, if anywhere, it might be hiding. Besides, if palm civets actually are one of the animal reservoirs of the virus, a reckless cull, the WHO has warned, would risk spreading the disease by causing unnecessary contact between civets and people. It might also eliminate valuable evidence about where SARS came from.

In contrast with the panic that gripped Chinese cities during the last outbreak, locals seem to be relaxed this time. They feel that the government is taking action and has measures in place to keep future cases under control. And that, perhaps, is what is really driving the cull—the need to demonstrate that politicians are now taking matters seriously. In reality, though, what is crucial is being quick to isolate any future patients and trace everyone they have been in contact with.

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The Voynich manuscript

Another twist in the tale

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From The Economist print edition

A possible explanation for the world's most enigmatic book

Worth 600 ducats of anybody's money!

THE Voynich manuscript, once owned by Emperor Rudolph II in 16th-century Bohemia, is filled with drawings of fantastic plants, zodiacal symbols and naked ladies. Far more intriguing than its illustrations, however, is the accompanying text: 234 pages of beautifully formed, yet completely unintelligible script.

Modern scholars have pored over the book since 1912, when Wilfrid Voynich, an American antiquarian, bought the manuscript and started circulating copies in the hope of having it translated. Some 90 years later, the book still defies deciphering. It now resides at Yale University.

The manuscript is written in “Voynichese”, which consists of strange characters, some of which look like normal Latin letters and Roman numerals. Some analysts have suggested that Voynichese is a modified form of Chinese. Others think it may be Ukrainian with the vowels taken out. But Voynichese words do not resemble those of any known language. Nor is the text a simple transliteration into fanciful symbols: the internal structure of Voynichese words, and how they fit together in sentences, is unlike patterns seen in other languages.

Another possibility is that the text is written in code. But the best efforts of cryptographers over the past 30 years have failed to crack it. This resilience is unusual, given that other ciphers from the period have yielded their secrets.

On the other hand, the text could just be gibberish and the book—which may have been passed off to Emperor Rudolph as the work of Roger Bacon, a 13th-century natural philosopher, in exchange for the princely sum of 600 gold ducats—a grand hoax. But Gabriel Landini, a Voynichese enthusiast at the University of Birmingham, in England, argues against this theory. Given the complex structure of Voynichese words, writing hundreds of pages of internally consistent gibberish would be a tough task for a fraudster to pull off.

But perhaps not an impossible one. Gordon Rugg, a computer scientist at Keele University, in England, thinks he may be one step closer to an explanation of how the text might have been created. In a paper published in the January issue of *Cryptologia*, he uses low-tech 16th-century methods, rather than 20th-century computing, to generate text resembling that in the book.

If the Voynich manuscript is a fraud, then one plausible suspect is Edward Kelley, an Elizabethan con-artist. So Dr Rugg borrowed one of Kelley's techniques. He used a grid of 40 rows and 39 columns to create a table which he filled in with Voynichese syllables. He then placed a grille—a piece of cardboard with three squares cut out in a diagonal pattern—on top of the table, and started forming words by reading off the syllables as he moved the grille across columns and down rows. The result was words with the same internal patterns as Voynichese. Dr Rugg and his team are now writing software to create dozens of tables and grilles in an attempt to reproduce other linguistic patterns in the manuscript. If their findings hold up, it would mean that the regularity of Voynichese is no longer an argument against the manuscript being an elaborate hoax.

Of course, this does not prove that the manuscript is nonsense—an impossible thing to demonstrate, in any case, since failure to find meaning in the text does not make it meaningless, but simply beyond

current methods of decoding. Indeed, Dr Landini believes that the Voynich manuscript might yet yield to massive computing power. If it does, most people expect to find a work of modest historical interest, rather than the secret of life. As with most puzzles, the thrill of solution lies in the process, rather than the product.

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The war on terrorism

Breathlessly to victory

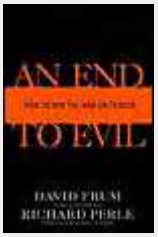
Jan 8th 2004
From The Economist print edition

Two American hawks offer a path to success

SHOULD Britain accept ever-closer union with its European neighbours? Most people who have an opinion one way or another live in Britain or on the European mainland. Many Americans, it is safe to guess, couldn't care less. Richard Perle and David Frum are exceptions. These influential Washington “neo-conservatives” believe that Britain needs to keep its strategic distance from Europe. Moreover, and strangely, they feel strongly about this because, in their view of the world since September 11th, it is part of how America can win the war on terrorism and, as their immodest title has it, put “an end to evil”.

In fairness, Britain and Europe crop up only towards the end of this “manual for victory”, tacked on to a breathtaking list of more urgent prescriptions. To win the war on terror, Mr Perle and Mr Frum want America (take that breath) to: reorganise the State Department (and the CIA, and the FBI, and the Pentagon); get tough with Saudi Arabia (perhaps by encouraging secession by the Shias of the oil-rich Eastern Province); help Iranians to overthrow their government; make Syria quit Lebanon (and reform its own economy and politics); impose a blockade of North Korea (and prepare a pre-emptive strike on its nuclear plants); revise the UN charter to make “pre-emption” easier; block France's ambition to make the EU a counter to America; campaign for the emancipation of Muslim women; and much, much else besides.

An End to Evil: How to Win the War on Terror
By David Frum and Richard Perle



Random House; 284 pages; $25.95

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Ambition is no sin in a book. Nor, heaven knows, is brevity. But a book of fewer than 300 pages that proposes to reorder so much of both the American system and the wider world is bound to skimp on detail. America's relations with the UN are settled in a brisk seven pages; those with Russia in fewer than three. This makes the reader wonder whether the boldness of the neo-conservative agenda is rooted—as they see it—in clear thinking, plain talking and moral courage, or whether it arises from a reckless disregard for complexity, shades of grey or the possibility of unintended consequences.

Certainly, this book contains plain talking. No tiptoeing around Muslim sensibilities for Mr Perle and Mr Frum: America, they aver, is at war with a radical strain of Islam that is intent on destroying western civilisation. This enemy does not consist just of a small group of conspirators, since the small group enjoys popular support and is backed by sundry rogue states, including nominal American allies such as

Saudi Arabia. Though conceding that the Middle East may be complicated, the authors do not want the complications to blur the big picture. “Religious extremists and secular militants; Sunnis and Shiites; communists and fascists—in the Middle East, these categories blend into one another. All gush from the same enormous reservoir of combustible rage. And all have the same target: the United States.”

So Muslim extremism is America's principal enemy. But in some passages the State Department seems to run the Islamists a close second. Mr Perle, a Reagan-era official, evidently has scores to settle. In Middle East policy, the authors complain, the State Department has deviated from “moral principles and common sense” and needs to be “yanked back into line”.

The authors do not quite specify where the department's sins lie, but provide hints. The fellows at Foggy Bottom seem to have pushed too hard for a Palestinian state. This book argues that, whatever its other merits, Palestinian statehood would have little impact on terrorism because no possible compromise in Palestine will end the terrorists' insatiable demands. They are also cross with State for stinting on support for Ahmed Chalabi, an Iraqi opposition leader who in exile became Mr Perle's friend. Or maybe State's crime is a want of patriotism. Often, Mr Perle and Mr Frum allege, State represents the world to America instead of America to the world.

Is that really such a bad thing to do? It is no job of the State Department to obstruct a president's foreign policy. In making policy, however, a president can use the advice of people with a feel for how the world might react to what America does. Perhaps this explains the animus of the neo-cons. They care little about the world's reaction to their agenda of global regime change and behaviour modification. The world, they say, brims with “hypocrites and scoff-laws”, notably the French, who are out to sabotage the necessary use of America's righteous power in Iraq and beyond. The best way to deal with such people is to ignore or, better, punish them.

George Bush has been accused of letting his foreign policy be steered by super-hawks such as Mr Perle. Some of their breezy optimism about America's ability to right all the world's wrongs, by force if necessary, has indeed rubbed off on policy. Yet this book also shows the limits of their influence. Its authors barely acknowledge that America's own power may be constrained. Mr Bush, since Iraq, seems shrewder on this. Nor, probably, does he think that the war on terror can be the sole organising principle of American policy—right down to what attitude to take to Britain's relations with Europe. The president finds it convenient to pose as the leader of a nation engaged since September 11th in a total war analogous to the war against Hitler. The neo-cons really believe it.

An End to Evil: How to Win the War on Terror.
By David Frum and Richard Perle.
Random House; 284 pages; $25.95

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Naval warfare

Blood brothers

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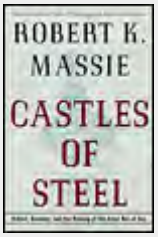
From The Economist print edition

KAISER WILHELM II wanted a chivalrous war at sea. “Gentlemen,” he told his admirals in November 1914, “always realise that our sword must be clean. We are not waging war against women and children. We wish to fight this war as gentlemen.” To modern ears it may sound like humbug, but the Kaiser really meant it. He was appalled to find his country, largely through his own grievous miscalculations, at war with Britain. He was, after all, Queen Victoria's eldest grandson and many of his top officers had relations or friends in the British navy. Before the war, the crews of German and British warships on foreign stations, invoking the brotherhood of the sea, customarily worked together and entertained one another.

But the longer fighting goes on, the more pitiless it gets. The first world war was not an exception. In his scholarly yet swashbuckling history of that conflict at sea, Robert Massie shows how early hopes of glorious sea battles, shared alike by the people of Britain and of Germany, foundered on the cruel reality of a war of attrition. The British Admiralty resisted national yearnings for Nelsonian gallantry and dash. The commander-in-chief of Britain's Grand Fleet, John Jellicoe, an unsentimental old salt, decided from the outset that the main purpose of his fleet was not to destroy the enemy's battleships but to maintain a naval blockade of ports that would eventually starve the Germans into submission.

Castles of Steel: Britain, Germany and the Winning of the Great War at Sea
By Robert K. Massie



Random House; 865 pages; $35. Jonathan Cape; £25

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The policy gradually ground the enemy down. Mr Massie tells how, by the winter of 1916, all foods except turnips were scarce in Germany. Milk was available to people over six years old only with a doctor's prescription. Eggs, which had been limited in September of that year to two per person a week, were doled out in December at one egg every two weeks. Pork, a staple of the German diet, disappeared. In August 1914, Berlin stockyards were slaughtering 25,000 pigs a week; by September 1916, only 350 a week.

After the British fleet foiled the German navy's attempt to break out into the Atlantic in the battle of Jutland, it too realised it would have to try to starve enemy civilians. Its U-boats were ordered to engage in unrestricted warfare, even if this meant sinking passenger liners and the trading ships of neutral nations. The tactic worked in the sense that Britain, like Germany, started to run out of food and fuel. But it was also in Mr Massie's view the colossal misjudgment that ensured Germany's defeat by bringing an entirely new enemy with unlimited resources into the war: the United States.

By then the slaughter at sea was as horrible as the slaughter in the bloody, muddy trenches of Flanders. Jacky Fisher, the founder of Britain's modern navy, was not at all surprised. The essence of war, he told British politicians more than a year before the outbreak of hostilities, was violence; moderation in war was imbecility. “You might as well talk of humanising hell!” The Kaiser learnt it the hard way.

Castles of Steel: Britain, Germany and the Winning of the Great War at Sea.
By Robert K. Massie.
Random House; 865 pages; $35. Jonathan Cape; £25

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Brazil's rural struggle

My own bit of land

Jan 8th 2004
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FOUR-FIFTHS of Brazil's population lives in cities, so it is mainly there that the country's terrible inequities will have to be cured. But the movement for social justice that has captured the world's imagination is a rural one, the Movimento dos Trabalhadores Rurais Sem Terra (MST), or movement of landless rural workers. Noam Chomsky, an American leftist intellectual, recently called it “the most important and exciting popular movement in the world”.

That is surely because the struggle in which it is engaged is violent in recent times, elemental and morally stark, pitting a million poor members against a handful of landlords who behave with the lordly impunity of feudal barons. The MST wants land, so that its members can lead productive, dignified lives, and is prepared to invade “unproductive” estates to get it. More than 1,000 rural leaders have died in clashes with police or the landlords' private armies. This year has been among the most violent: 84 people died in Brazil's land wars between January and November 2003, a 40% rise over the year before.

Angus Wright and Wendy Wolford, both professors in the United States, milk this struggle for all its drama, and show convincingly that the MST is central to the wider project of establishing democracy and justice in Brazil. Things began badly for social equality with the Portuguese handing out huge tracts of land to discourage French and Spanish designs on their Brazilian colony. Many big *latifundios* were assembled through fraud (landlords would put forged deeds into boxes full of crickets to make them look antique).

To Inherit the Earth: The Landless Movement and the Struggle for a New Brazil
By Angus Wright and Wendy Wolford

Food First Books; 368 pages; $15.95

Buy it at Amazon.com

AFP

First, build a home

The 20-year-old MST is heir to a tradition of dissent against this order, kin to *quilombos*, communities of escaped slaves, and to Canudos, a township founded in the 1890s by a charismatic rebel against the authority of the new republic, which was crushed by government troops. (The authors do not note that Canudos favoured the deposed monarchy.) The MST itself was born during the waning years of military rule and has kept up its struggle in a polity it considers insufficiently democratic. With the election of a long-time MST supporter, Luiz Inácio Lula da Silva, as president of Brazil in 2002, there is a chance that the antagonism between movement and state will lessen. He has recently promised to settle 530,000 landless families over the next few years.

Professors Wright and Wolford have travelled from Rio Grande do Sul, in Brazil's fertile south, to the Amazon frontier, visiting encampments, where the MST has seized land, and settlements, where the movement has gained title to it. They tell the activists' stories and ask questions: Are the settlers better off than when they were landless? Why do some settlements succeed and others fail?

The authors strike a pose of objectivity but do not sustain it. They accept the MST's view that big farming, “chemical-dependence”, free trade and chopping down the Amazon form a composite evil and that greenery, Indian rights and small-scale farming are an indivisible good. The settlers are not always keen on the MST's exhortations to abjure pesticides and live communally, the authors note, but that does not lead them to question the movement's conflicting notions. This leads to some bizarre judgments (praise for European agricultural protection, even though poor-country farmers suffer from it) and errors of fact (poverty has not worsened in Brazil since the end of military rule).

The authors provide historical and political background but too little economic and social context, which makes it hard to judge how much good the MST can do. Does it make economic sense to create more family farms? Do big farms really pay “starvation wages”? Yes, say the authors, without persuading the reader.

The MST is right to say that land is only a first step toward better lives for its members. The schools and the culture of questioning that the movement helps bring to its communities may matter even more. A settler in the Amazon, a former petty criminal, exults: “Now I know what a concept is when you use the word. Before, I would have had no idea what you were talking about.” That observation is worth much. But it is hard to see a movement that rails against “spontaneity” as having all the answers for Brazil.

To Inherit the Earth: The Landless Movement and the Struggle for a New Brazil.
By Angus Wright and Wendy Wolford.
Food First Books; 368 pages; $15.95

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Gay history

Prudes and prejudice

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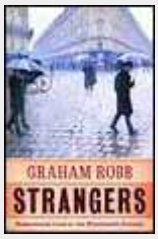
From The Economist print edition

AFTER 27 men were arrested at a male brothel in London's Vere Street in 1810, a friend of Lord Byron wrote to tell him that six men were convicted and put in the pillories, where crowds flung manure and offal at them for hours. He wryly commented that, unlike the poet, who was safe and evidently enjoying himself in Turkey, "that wch you get for £5 we must risque our necks for." But, he added, "[we] are content to risque them."

To today's gays the Victorian age was a barbaric, backward time. But as Byron's friend indicated, even then, 51 years before Britain abolished the death penalty for sodomy, the law was applied selectively enough to be a small risk to homosexuals. That same year saw fewer than 60 sodomy-related convictions. Sherlock Holmes's flight to Europe after a brush with death in Vere Street, though it was nearly a century later, is taken by some critics as one of several hidden hints that the bachelor detective was one of mainstream literature's first gay protagonists. Even Oscar Wilde's notorious trial was largely his own fault, brought on by his foolhardy libel suit against the Marquess of Queensberry for calling him a "posing somdomite" (sic).

Strangers: Homosexual Love in the Nineteenth Century
By Graham Robb



W.W. Norton; 352 pages; $27.95.
Picador; £18.99

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Amazon.co.uk

Indeed, as Graham Robb shows in his finely researched study, the Victorian era's puritan prudery was only its public face. Wilde's sympathisers were as many as his detractors, just quieter. Behind the masks of disapproval, gay life existed and even flourished. The big European and American cities had gay cafés, meeting clubs, brothels and even regular drag balls attended by hundreds of men in their finest chiffon.

Those who know what certain parts of London's Hampstead Heath are used for nowadays will be either shocked or thrilled to learn that in Paris in the 1830s parts of the Champs-Elysées were roped off after dark, with sentries placed to warn off casual passers-by (one of whom was a surprised Victor Hugo). And when the French police tried to clean up the district they were met with armed resistance, well over a century before New York's Stonewall riots, the supposed flashpoint of modern gay activism.

The period could even be described as something of an enlightenment, with the first serious arguments for reforming the law regarding homosexuals and treating them medically. Paradoxically, the 20th century was in many ways more repressive, when the relatively benign early "cures" such as hypnosis, marrying "effeminate" gay men to "manly" lesbians, or sending them to brothels, were replaced by brutal aversion therapy, castration and lobotomies.

Mr Robb ranges widely and eruditely, also taking in gay roles in literature and religion. An era so steeped in airy metaphor and squeamish obfuscation is the perfect target for his sense of humour, such as when he dissects the evolution of lesbian characters in fiction. In the Romantic period they

> ...gazed at themselves in mirrors, stared out to sea, anticipated eternal damnation and, for an obscure reason, gnawed the bark of young trees. The fin-de-siècle lesbian was... frighteningly self-possessed, wore dark colours, read novels, smoked cigars, injected morphine or inhaled ether, suffered from excess hair except on the head, spent too much time in conditions suitable for tropical plants, and was prone to horrible diseases. But at least...she had developed other interests and had a social life.

Inevitably, since he relies on the written record, Mr Robb says more about the relatively free lives of the privileged few who wrote most of it. Ordinary men and women appear mostly as the subjects of

psychological studies or as sexual servants to the upper classes. But Mr Robb seems to have plumbed pretty much every source available; and he finds enough evidence that in the 19th-century world, as in much of today's, the gay life, though it was often hard and constrained, could still be worth the living.

Strangers: Homosexual Love in the Nineteenth Century.
By Graham Robb.
W.W. Norton; 352 pages; $27.95.
Picador; £18.99

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About sponsorship

A new thriller

Philosopher's choice

Jan 8th 2004
From The Economist print edition

MOST thrillers begin with a murder or a kidnapping or some other dread deed. “The Havana Room” begins with a quote from Schopenhauer. The weighty epigraph signals an engagingly unconventional thriller, full of ruminations on the human condition.

Bill Wyeth is a property lawyer with a top Manhattan firm. Handsome and hard-working, he is well on the way to the really big bucks. His relationship with his snooty and highly-strung wife, Judith, is not what it used to be, but the marriage is held together by the parents' love of their young son, Timothy.

But the family's world is turned upside down when one of Timothy's schoolfriends dies in an accident in their apartment. For Bill, the consequences are catastrophic. He soon finds himself unemployed, divorced and cold-shouldered by his friends and colleagues.

After months of moping around in a prescription-drug daze, Bill drops into a midtown steakhouse and falls for the leggy manageress, Allison. One night, hoping to please Allison, he agrees to help a friend of hers finalise a last-minute real-estate deal. The deal is brokered in the restaurant's private bar, the Havana Room—all cosy banquettes, swirling cigar smoke, low lighting and olde-worlde trappings.

Bill knows there's something a bit dodgy about the deal. Just how dodgy, though, only becomes clear over time. Suffice to say that it involves plenty of sex, zoning regulations and Chinese cookery.

Colin Harrison keeps the pages turning at a spanking clip. The book is nicely put together for maximum suspense, and is strong on characterisation. Mr Harrison is much more interested in the subtler shadings of goodness and weakness than he is in the gaudy displays of bang-pow-splat that typify so many other thrillers.

The only thing that detracts from all this is the occasional overwriting. Most of the time, though, Mr Harrison manages to keep his purplish tendencies in check, and Schopenhauer himself might have enjoyed whiling away an idle afternoon on the beach with this superior thriller.

The Havana Room.
By Colin Harrison.
Farrar, Straus and Giroux; 400 pages; $24. To be published in Britain by Bloomsbury in April

The Havana Room
By Colin Harrison

Farrar, Straus and Giroux; 400 pages; $24. To be published in Britain by Bloomsbury in April

Buy it at
Amazon.com

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About sponsorship

Cinema

At the summit

Jan 8th 2004 | LOS ANGELES
From The Economist print edition

A hot tip for the success of the film “Cold Mountain”

Genteel Nicole

ANTHONY MINGHELLA'S new film “Cold Mountain”, a love story set against the American civil war, is the kind of movie Oscar loves, not least because every craft department is a star. For “Cold Mountain” Mr Minghella has reassembled the team that helped “The English Patient” win nine Academy awards, among them John Seale, cameraman, Dante Ferretti, designer, and Walter Murch, editor.

All departments get a chance to shine in the opening sequence portraying the Battle of the Crater at Petersburg, Virginia. The Union soldiers tunnel under the Confederate camp and blow it up; when they attack and fall into the pit they've created, the Confederates slaughter them in turn. Mr Murch's editing pays tribute to the Battle of Shrewsbury sequence in Orson Welles's “Chimes at Midnight”. Like Welles, the makers of “Cold Mountain” mean to deny the audience support for either side of this war—and by extension, of any war.

After the battle, a Confederate soldier named Inman who was shot in the throat thinks back to his brief courtship three years earlier with Ada Monroe, a southern belle who came with her preacher father to live in the North Carolina village of Cold Mountain. Subsequently the film alternates between Ada, who orders Inman in a letter to return to her, and Inman, who deserts and embarks on the perilous journey home. Nicole Kidman's performance as Ada, whose genteel upbringing poorly equips her to survive deprivation and terror at the hands of marauders, reminds us what a movie star is, and Jude Law as Inman finally emerges from the character parts he has been playing to become a star in his own right.

But it is Renée Zellweger who steals the movie as Ruby, the begrimed, sharp-tongued hillbilly who helps Ada save her farm. Ruby and Ada are eventually joined by the widowed Sally Swanger (Kathy Baker), and in keeping with the film's feminism, Inman is helped by an old goat-herder (Eileen Atkins) and a young widow (Natalie Portman). Mr Minghella's encounter with Charles Frazier's novel has certainly not hurt his film-making. “The English Patient” was arty, but the ravishing photography of “Cold Mountain” powers a romantic story with wide appeal, which might just duplicate its predecessor's exploits come Oscar night.

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About sponsorship

Kriangsak Chomanan

Jan 8th 2004
From The Economist print edition

Bangkok Post

Kriangsak Chomanan, a Thai coup leader, died on December 23rd, aged 86

WHEN Kriangsak Chomanan had ambitions to become prime minister of Thailand in 1977 he took what was then the conventional route to power: with a number of other army officers he staged a coup. No one was very surprised. Some Thais were grateful. The previous prime minister, who was also installed after a military coup, had proved to be too harsh even for army tastes. An acquiescent parliament approved the appointment of General Kriangsak and the king, as the formal head of state, wearily gave him his blessing.

Until 1932 Thailand, then called Siam, had been ruled by a monarch with absolute powers. But a growing middle class, led by a lawyer trained in France, demanded democracy (as seems to be happening now in China). The king yielded and granted a constitution on modern lines with a parliament and elections.

In the event, it turned out that Thailand had replaced absolute monarchy with domination by the army. Democracy was tried from time to time, but discarded by generals who felt they could do better. When General Kriangsak became prime minister in 1977 there had been 13 coups or attempted coups since 1932. Schoolchildren in Thailand learn their history in terms of coups, such as the Grand Palace Coup of 1949 and the Manhattan Coup of 1951 (named after a ship stormed by coup leaders). As each new leader emerged promising liberty, prosperity and general happiness, a new constitution would be drawn up to show he meant business. General Kriangsak's constitution was Thailand's 12th since 1932.

The clever kings

Thailand is the only country in South-East Asia that managed to escape being colonised in the 19th century and did so because its royal dynasty produced two remarkable men. Rama IV (1851-68) astutely played off the European powers against each other. Rama V (1868-1910) inherited his father's diplomatic skills and encouraged the beginnings of a modern state, with good communications and an education system that eventually led to the revolt of the middle classes.

General Kriangsak also deserves a note of credit. He was one of the brighter products of the coup system, otherwise notable for its duds. He seems to have remained an honest man in an army famous for its corruption, running smuggling rackets across the country's borders, and lining the pockets of generals who became involved in business. In General Kriangsak's time the army had 700 generals or, as one observer noted, one for every tank. Neither the generals nor the tanks had much to do. Thailand had

no external enemies. The military regime in Burma (now Myanmar) would occasionally make trouble on the border, but was no more than an irritant to the generals, who would usually be worsted. “Better in the brothel than on the battlefield,” was the verdict in Bangkok.

The army was quite unable to cope with a communist insurgency that had started in the mid-1960s and eventually enveloped a large part of northern Thailand. General Kriangsak has to share the blame for the army's ineptitude, but he had the brains to see that the insurgency would be ended only when China stopped sending arms and other supplies to the guerrillas. In a move that Rama IV would have approved of, he went to Beijing in 1979 to see if he could do a deal with Deng Xiaoping, soon to become China's supreme leader.

What could Thailand offer China in return for an end to Chinese support for the insurgents? The timing was right. China was looking for ways to bring Vietnam to heel, once its friend but since the end of the Vietnam war in 1975 increasingly independent-minded. Deng asked General Kriangsak to allow aid to be moved across Thai territory to Cambodia, where Pol Pot's Khmer Rouge forces had taken to the jungle in Cambodia after being defeated by the Vietnamese. The general agreed, Pol Pot got his supplies, the Vietnamese suffered casualties and the Thai insurgency fizzled out. The Thais deny all this, particularly having anything to do with Pol Pot. But it is widely accepted that realpolitik triumphed under General Kriangsak.

The general, a family man (a son and a daughter), was less successful in another ambition: to rescue Bangkok and other Thai cities from becoming the sex capitals of Asia. During the Vietnam war Thailand was host to many Americans, thousands manning the bomber bases, thousands more back from the war front on leave. A sex industry grew up to meet their needs and continued after the Americans left. Whether General Kriangsak could have closed down a business that has become an important part of tourism is anyone's guess. He left politics. In 1980 he astonished Thailand by taking the democratic step of resigning rather than being overthrown, telling parliament that he no longer felt he had the support of the public.

It seemed to be the beginning of the end of government by coup in Thailand. Just as in 1932 many Thais felt they deserved better than to have a king with medieval powers, in the 1990s their descendants decided they could no longer be ruled by soldiers. Thailand has not had a coup since 1991. Schoolchildren, at least, term that the Final One.

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Overview

Jan 8th 2004
From The Economist print edition

The euro rose to another record high against the **dollar** this week, hitting $1.28, more than 50% above its low point in 2001. The yen hit a three-year high of ¥106 against the dollar, and sterling an 11-year high of $1.83.

America's ISM manufacturing index rose sharply in December to its highest level for 20 years. But the ISM non-manufacturing index fell for the second month running.

The European Commission's index of business confidence in the **euro area** fell in December for the first time in five months. In the same month, **French** consumer confidence remained close to a six-year low. **German** retail sales fell by 2.5% in the year to November. The only good news was that French unemployment fell to 9.6% in November from a three-and-a-half year peak of 9.7% in October.

The average inflation rate in the **euro area** edged down to 2.1% in December, but that is still above the European Central Bank's inflation goal of “less than but close to 2%”. Germany's inflation rate fell to 1.1%, while Italy's held steady at 2.5%.

Canada's inflation rate was 1.6% in November, down from 4.3% a year earlier. Producer prices fell by 4.0% in the year to November, thanks partly to the strong Canadian dollar.

Switzerland's rate of consumer-price inflation rose to 0.6% in December.

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Output, demand and jobs

Jan 8th 2004
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2003	2004	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.6	Q3	+ 4.8	+ 2.8	+ 3.6	+ 1.3	Q2	+ 5.3	Q3	5.6	Nov	6.1
Austria	+ 0.7	Q2	+ 1.1	+ 0.8	+ 1.9	+ 2.5	May	– 4.0	Aug	4.5	Oct	4.3
Belgium	+ 0.7	Q3	+ 2.0	+ 1.0	+ 1.9	– 4.8	Oct	+ 3.4	Oct	12.7	Dec†	11.7
Britain	+ 2.0	Q3	+ 3.1	+ 2.0	+ 2.8	+ 0.9	Oct	+ 3.7	Nov	5.0	Oct††	5.2
Canada	+ 1.0	Q3	+ 1.1	+ 1.7	+ 3.1	– 0.3	Oct	+ 3.1	Sep	7.5	Nov	7.5
Denmark	– 0.8	Q3	– 1.2	+ 0.5	+ 2.2	– 1.5	Oct	+ 5.5	Oct	6.5	Nov	5.4
France	– 0.3	Q3	+ 1.5	+ 0.2	+ 1.9	+ 0.5	Oct	– 2.2	May	9.6	Nov	9.2
Germany	– 0.2	Q3	+ 0.9	– 0.1	+ 1.7	+ 0.8	Oct	– 2.5	Nov‡	10.4	Dec§	10.1
Italy	+ 0.5	Q3	+ 2.0	+ 0.5	+ 1.7	+ 0.4	Oct	– 0.4	Sep	8.5	Jul	9.0
Japan	+ 1.8	Q3	+ 1.4	+ 2.4	+ 2.1	+ 2.4	Nov	+ 0.3	Oct	5.2	Nov	5.3
Netherlands	– 1.1	Q3	+ 0.5	– 0.7	+ 1.1	– 0.1	Oct	na	nil	5.7	Nov**	4.3
Spain	+ 2.4	Q3	+ 2.9	+ 2.4	+ 3.0	+ 0.6	Oct	+ 2.5	Sep	11.2	Oct	11.4
Sweden	+ 2.0	Q3	+ 1.9	+ 1.6	+ 2.5	+ 2.1	Oct	+ 3.9	Nov	3.9	Nov†	3.9
Switzerland	– 0.6	Q3	+ 1.0	– 0.4	+ 1.6	+ 0.4	Q3	+ 1.4	Oct	4.1	Dec†	3.3
United States	+ 3.5	Q3	+ 8.2	+ 3.1	+ 4.5	+ 1.6	Nov	+ 7.8	Oct	5.9	Nov	5.9
Euro area	+ 0.3	Q3	+ 1.5	+ 0.5	+ 1.9	+ 0.9	Oct	– 0.6	Sep	8.8	Oct	8.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 1.6	Q3	+ 3.2	na	na	+ 0.3	Nov	+ 3.6	Sep	8.2	Nov†	8.2
Greece	+ 5.0	Q3	+ 1.8	na	na	– 0.3	Aug	na		na		na
Iceland	+ 3.2	Q3	na	na	na	– 0.3	2002	na		2.8	Oct†	2.5
Ireland	+ 2.1	Q2	na	na	na	+11.5	Oct	+ 1.0	Oct	4.3	Nov	4.3
Luxembourg	+ 1.1	2002	na	na	na	+ 1.4	Sep	+ 6.8	Jul	4.0	Oct	3.2
New Zealand	+ 3.5	Q3	+ 6.3	na	na	+ 2.5	Q2	+ 6.1	Q3	4.4	Q3	5.4
Norway	+ 0.2	Q3	+ 3.3	na	na	– 3.6	Oct	+ 1.6	Nov	4.7	Q3	3.8
Portugal	– 0.9	Q3	– 2.1	na	na	– 1.0	Oct	– 0.7	Oct	6.3	Q3†	5.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Aug-Oct; claimant count rate 3% in Oct. §EU harmonised rate 9.2% in Dec. **Sep-Nov.

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Prices and wages

Jan 8th 2004
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2003	2004	latest		year ago	latest		year ago
Australia	+ 2.6	Q3	+ 3.2	+ 2.7	+ 2.3	– 0.1	Q3	– 0.2	+ 5.1	Q3	+ 3.6
Austria	+ 1.3	Nov	+ 1.7	+ 1.3	+ 1.2	+ 2.5	Dec	+ 0.8	+ 2.3	Oct	+ 2.3
Belgium	+ 1.7	Dec	+ 1.4	+ 1.5	+ 1.4	– 0.4	Nov	+ 1.4	+ 1.9	Q3	+ 2.1
Britain	+ 1.3	Nov	+ 1.6	+ 2.8	+ 2.5	+ 1.7	Nov	+ 0.9	+ 3.6	Oct	+ 3.7
Canada	+ 1.6	Nov	+ 4.3	+ 2.7	+ 1.6	– 4.0	Nov	+ 2.3	+ 3.1	Sep	+ 2.4
Denmark	+ 1.5	Nov	+ 2.7	+ 2.1	+ 1.6	+ 0.6	Nov	+ 0.8	+ 3.6	Q3	+ 3.9
France	+ 2.3	Nov	+ 2.2	+ 2.1	+ 1.7	+ 0.7	Nov	+ 0.9	+ 3.0	Q3	+ 3.5
Germany	+ 1.1	Dec	+ 1.2	+ 1.1	+ 1.1	+ 1.5	Nov	+ 1.1	+ 2.1	Oct	+ 2.6
Italy	+ 2.5	Dec	+ 2.8	+ 2.8	+ 2.3	+ 1.1	Nov	+ 1.6	+ 2.5	Nov	+ 2.2
Japan	– 0.5	Nov	– 0.4	– 0.2	– 0.2	– 0.5	Nov	– 1.2	+ 0.6	Nov	+ 0.6
Netherlands	+ 1.7	Dec	+ 2.8	+ 2.2	+ 1.7	+ 2.6	Nov	+ 2.2	+ 2.4	Nov	+ 3.3
Spain	+ 2.8	Nov	+ 3.9	+ 2.9	+ 2.6	+ 1.3	Nov	+ 1.6	+ 3.1	Q3	+ 3.8
Sweden	+ 1.4	Nov	+ 2.3	+ 2.1	+ 1.5	– 1.6	Nov	– 0.8	+ 3.1	Oct	+ 3.1
Switzerland	+ 0.6	Dec	+ 0.9	+ 0.6	+ 0.5	– 0.2	Nov	– 0.4	+ 1.8	2002	+ 2.5
United States	+ 1.8	Nov	+ 2.2	+ 2.3	+ 1.5	+ 3.4	Nov	+ 1.0	+ 2.1	Nov	+ 3.0
Euro area	+ 2.1	Dec	+ 2.3	+ 2.0	+ 1.7	+ 0.9	Oct	+ 1.1	+ 2.9	Q2	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.5	Nov	+ 1.7	na	na	– 0.2	Nov	+ 1.1	+ 3.9	Q3	+ 4.1
Greece	+ 3.3	Sep	+ 3.5	na	na	+ 2.2	Aug	+ 2.1	na		na
Iceland	+ 2.7	Dec	+ 2.0	na	na	+ 3.5	Dec	+ 5.9	+ 5.5	Nov	+ 5.7
Ireland	+ 2.2	Nov	+ 4.8	na	na	– 8.4	Nov	– 3.0	+ 4.7	Q3	+ 6.0
Luxembourg	+ 1.8	Nov	+ 2.2	na	na	+ 0.7	Oct	+ 0.3	+ 2.5	Sep	+ 1.6
New Zealand	+ 1.5	Q3	+ 2.6	na	na	+ 0.1	Q3	– 2.1	+ 2.3	Q3	+ 2.3
Norway	+ 1.4	Nov	+ 2.1	na	na	+ 7.4	Nov	+ 3.2	+ 4.3	Q3	+ 5.0
Portugal	+ 2.5	Nov	+ 4.0	na	na	– 0.3	Nov	+ 1.7	– 1.3	Oct	+ 0.6

* New series. RPI inflation rate in November: 2.5%.

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Economic forecasts

Jan 8th 2004
From The Economist print edition

The Economist poll of forecasters, January averages (previous month's, if changed)

	Real GDP, % change Low/high range		Real GDP, % change average		Consumer prices % increase		Current account % of GDP	
	2003	2004	2003	2004	2003	2004	2003	2004
Australia	2.4/3.5	2.4/4.3	2.8 (2.6)	3.6 (3.8)	2.7 (2.8)	2.3	–5.9(–5.7)	–5.2 (–4.9)
Austria	0.5/1.0	1.6/2.2	0.8 (0.7)	1.9 (1.7)	1.3	1.2 (1.1)	–0.1 nil	–0.1
Belgium	0.6/1.5	1.6/2.2	1.0 (1.3)	1.9 (1.7)	1.5 (1.6)	1.4 (1.5)	4.4 (4.3)	4.4
Britain	1.8/2.2	2.4/3.5	2.0	2.8 (2.7)	2.8 (2.7)	2.5	–1.9	–1.9 (–1.7)
Canada	1.6/2.0	2.5/3.9	1.7 (1.9)	3.1 (3.0)	2.7	1.6 (1.7)	1.9 (1.8)	1.5 (1.4)
Denmark	0.1/0.9	1.8/2.5	0.5 (0.7)	2.2 (2.1)	2.1 (2.2)	1.6	2.9 (2.8)	2.7
France	0.1/0.4	1.5/2.8	0.2	1.9 (1.8)	2.1	1.7 (1.6)	1.3 (1.4)	1.3 (1.4)
Germany	–0.2/nil	1.2/2.3	–0.1 nil	1.7 (1.6)	1.1	1.1 (1.0)	2.4 (2.3)	2.6 (2.3)
Italy	0.4/0.6	0.9/2.3	0.5 (0.4)	1.7 (1.6)	2.8 (2.7)	2.3 (2.2)	–1.1(–1.0)	–1.0 (–0.8)
Japan	2.1/2.9	1.4/2.9	2.4 (2.6)	2.1 (2.0)	–0.2	–0.2	3.0 (2.9)	3.0 (2.9)
Netherlands	–0.9/–0.5	0.5/1.8	–0.7	1.1	2.2 (2.3)	1.7	2.9 (2.6)	3.2 (2.8)
Spain	2.1/2.4	2.6/3.5	2.4 (2.3)	3.0 (2.9)	2.9 (3.1)	2.6	–2.3(–2.4)	–2.3
Sweden	1.1/1.9	2.2/3.2	1.6 (1.5)	2.5 (2.4)	2.1 (2.2)	1.5 (1.6)	4.6 (4.2)	4.4 (4.1)
Switzerland	–0.6/–0.2	0.9/2.3	–0.4	1.6 (1.4)	0.6	0.5 (0.6)	10.8(11.0)	10.7 (10.9)
United States	2.9/3.1	3.7/5.1	3.1 (2.9)	4.5 (4.2)	2.3	1.5	–5.0(–5.1)	–5.3
Euro area	0.2/0.5	1.4/2.6	0.5	1.9 (1.8)	2.0	1.7 (1.6)	0.4	0.6 (0.5)

Sources: ABN Amro, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, Merrill Lynch, J.P. Morgan Chase, Morgan Stanley, Nordea, Decision Economics, BNP Paribas, Royal Bank of Canada, Citigroup, Scotiabank, UBS

Every month *The Economist* calculates the average of a group of forecasters' predictions for economic growth, inflation and current-account balances for 15 countries and for the euro area. The table also shows the highest and lowest projections for growth. The previous month's figures, where they are different, are shown in brackets. The panel is expecting a vigorous upturn in 2004. It has raised this year's growth forecasts for 13 out of the 15 countries. The United States is now tipped to grow by 4.5%, up from 4.2% last month. The euro area and Japan are forecast to grow by 1.9% and 2.1% respectively, up from 1.8% and 2.0% in December. The panel has cut its growth forecast for just one country, Australia, to 3.6% from last month's 3.8%. The Netherlands will bring up the rear, with GDP predicted to increase by just 1.1%.

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Money and interest rates

Jan 8th 2004
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Jan 7th 2004)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 8.7	+13.0	Nov	5.53	4.81	5.45	5.78	5.21	6.62
Britain	+ 8.0	+ 7.0	Nov	4.00	3.94	4.35	4.79	4.42	5.48
Canada	+ 5.2	+ 6.0	Nov	2.51	2.68	2.92	4.70	4.89	6.07
Denmark	+ 8.1	+ 9.9	Nov	2.20	3.14	2.67	4.35	4.47	6.40
Japan	+ 5.3	+ 1.6	Nov	0.02	0.03	0.12	1.37	0.89	1.48
Sweden	+ 2.9	+ 3.6	Nov	2.63	3.64	2.86	4.66	4.71	3.51
Switzerland	+24.4	+ 8.5	Nov	0.26	0.63	-1.00	2.62	2.28	2.52
United States	+ 6.6	+ 4.6	Nov	1.03	1.28	1.82	4.24	3.97	5.87
Euro area†	+10.7	+ 7.4	Nov	2.10	2.85	2.55	4.19	4.19	3.98

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.09%, Japan No. 256 1.37%. Central bank rates: US fed funds 1.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 3.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Jan 8th 2004
From The Economist print edition

1995=100

	Dec 23rd*	Dec 30th	Jan 6th†	% change on one month	% change on one year
Dollar index					
All items	88.0	89.0	91.0	+ 1.8	+19.2
Food	85.4	85.8	87.4	– 2.5	+ 9.6
Industrials					
All	91.5	93.3	95.8	+ 7.6	+33.6
Nfa‡	89.7	90.9	91.7	+ 3.8	+22.7
Metals	93.0	95.3	99.3	+10.7	+43.6
Sterling index					
All items	78.6	78.8	78.8	– 2.7	+ 5.1
Euro index					
All items	93.2	93.4	93.9	– 2.6	– 2.5
Yen index					
All items	100.5	101.3	102.9	+ 0.6	+ 5.5
Gold					
$ per oz	409.75	416.45	422.25	+ 3.7	+21.0
West Texas Intermediate					
$ per barrel	32.02	32.94	33.62	+ 5.8	+ 7.9

* Revised. † Provisional. ‡ Non-food agriculturals.

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Stockmarkets

Jan 8th 2004
From The Economist print edition

Market indices

	Jan 7th	2003-04 high	2003-04 low	% change on one week	% change on record high	% change on Dec 31st 2002 in local currency	% change on Dec 31st 2002 in $ terms
Australia (All Ordinaries)	3,309.9	3,325.4	2,673.3	+ 0.1	– 3.8	+11.2	+51.9
Austria (ATX)	1,611.4	1,611.4	1,120.2	+ 4.3	– 7.2	+40.1	+69.4
Belgium (Bel 20)	2,295.1	2,295.1	1,426.6	+ 2.3	–37.7	+13.3	+37.0
Britain (FTSE 100)	4,473.0	4,513.3	3,287.0	– 0.1	–35.5	+13.5	+28.4
Canada (Toronto Composite)	8,388.5	8,405.1	6,228.6	+ 2.0	–26.3	+26.8	+55.8
Denmark (KBX)	220.1	222.6	145.0	+ 3.1	–27.1	+32.4	+59.7
France (SBF 250)	2,426.5	2,446.4	1,630.1	+ 0.6	–44.7	+18.2	+42.9
(CAC 40)	3,563.5	3,608.3	2,403.0	+ 0.2	–48.5	+16.3	+40.6
Germany (DAX)	4,004.4	4,035.9	2,203.0	+ 1.0	–50.3	+38.4	+67.4
Italy (BCI)	1,270.1	1,286.7	959.4	+ 1.1	–41.8	+16.3	+40.7
Japan (Nikkei 225)	10,757.8	11,161.7	7,607.9	+ 0.8	–72.4	+25.4	+40.2
(Topix)	1,051.6	1,105.6	770.6	+ 0.8	–63.5	+24.7	+39.4
Netherlands (AEX)	340.2	343.7	218.4	+ 0.7	–51.5	+ 5.4	+27.5
Spain (Madrid SE)	825.7	825.7	576.8	+ 2.2	–28.0	+30.2	+57.5
Sweden (Affarsvarlden Gen)	188.5	190.3	127.8	+ 0.1	–52.9	+29.9	+57.8
Switzerland (Swiss Market)	5,583.4	5,596.6	3,675.4	+ 1.7	–33.6	+20.6	+35.0
United States (DJIA)	10,529.0	10,544.1	7,524.1	+ 0.7	–10.2	+26.2	+26.2
(S&P 500)	1,126.3	1,126.3	800.7	+ 1.3	–26.3	+28.0	+28.0
(NASDAQ Comp)	2,077.7	2,077.7	1,271.5	+ 3.7	–58.8	+55.6	+55.6
Europe (FTSE Eurotop 300)*	967.4	973.0	682.7	+ 1.0	–43.3	+12.9	+36.5
Euro area (FTSE Ebloc 100)*	839.5	846.4	565.7	+ 0.9	–45.9	+16.9	+41.3
World (MSCI)†	1,052.1	1,054.3	710.8	+ 1.5	–27.4	+32.8	+32.8
World bond market (Citigroup)‡	608.6	609.1	518.6	+ 0.8	– 0.1	+15.8	+15.8

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

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	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2003	2004	Exchange rate trade-weighted† 1990=100 Jan 7th	year ago	Currency units per $ Jan 7th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2003‡
Australia	− 14.3	Oct	− 27.2	Q3	− 5.9	− 5.2	88.9	74.6	1.30	1.74	2.37	1.65	1.23	0.8
Austria	− 0.8	Sep	+ 0.8	Oct	− 0.1	− 0.1	102.8§	101.1	0.79	0.96	1.43	–	0.74	-1.3
Belgium	+ 20.7	Oct	+ 9.9	Sep	+ 4.4	+ 4.4	102.9§	100.4	0.79	0.96	1.43	–	0.74	0.2
Britain	− 74.4	Oct	− 36.1	Q3	− 1.9	− 1.9	101.8	104.5	0.55	0.63	–	0.70	0.52	-2.9
Canada	+ 42.0	Oct	+ 16.7	Q3	+ 1.9	+ 1.5	89.3	75.5	1.29	1.56	2.34	1.63	1.21	1.0
Denmark	+ 10.2	Oct	+ 5.4	Oct	+ 2.9	+ 2.7	107.1	103.7	5.87	7.15	10.7	7.45	5.53	0.8
France	+ 5.7	Oct	+ 21.3	Oct	+ 1.3	+ 1.3	106.3§	103.4	0.79	0.96	1.43	–	0.74	-4.0
Germany	+142.7	Oct	+ 58.2	Oct	+ 2.4	+ 2.6	103.8§	100.4	0.79	0.96	1.43	–	0.74	-4.1
Italy	+ 3.4	Oct	− 19.2	Oct	− 1.1	− 1.0	75.8§	73.7	0.79	0.96	1.43	–	0.74	-2.7
Japan	+100.6	Oct	+127.4	Oct	+ 3.0	+ 3.0	136.6	132.0	106	120	193	135	–	-7.4
Netherlands	+ 33.0	Oct	+ 17.7	Q3	+ 2.9	+ 3.2	102.3§	99.5	0.79	0.96	1.43	–	0.74	-2.4
Spain	− 50.5	Sep	− 24.1	Sep	− 2.3	− 2.3	77.0§	75.3	0.79	0.96	1.43	–	0.74	0.1
Sweden	+ 17.9	Nov	+ 14.8	Q3	+ 4.6	+ 4.4	82.5	78.8	7.17	8.75	13.1	9.10	6.75	0.2
Switzerland	+ 6.2	Nov	+ 29.4	Q3	+10.8	+10.7	111.4	116.0	1.24	1.40	2.25	1.57	1.16	na
United States	−549.5	Oct	−541.7	Q3	− 5.0	− 5.3	93.8	110.9	–	–	1.82	1.27	0.94	-4.9
Euro area	+ 86.7	Oct	+ 42.1	Oct	+ 0.4	+ 0.6	92.7	84.1	0.79	0.96	1.43	–	0.74	-2.7
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 14.4	Oct	+ 10.9	Oct	na	na	81.6§	79.3	0.79	0.96	1.44	–	0.74	2.6
Greece	− 24.8	Oct	− 10.7	Oct	na	na	59.4§	58.2	0.79	0.96	1.44	–	0.74	-1.6
Iceland	− 0.2	Nov	− 0.4	Q3	na	na	92.9**	91.9	70.0	81.4	127	88.8	65.9	-1.0
Ireland	+ 38.6	Oct	− 2.1	Q3	na	na	94.5§	89.8	0.79	0.96	1.44	–	0.74	-1.0
Luxembourg	− 3.4	Oct	+ 2.0	Q3	na	na	102.9§	100.4	0.79	0.96	1.44	–	0.74	-0.3
New Zealand	− 1.8	Nov	− 3.3	Q3	na	na	104.0	94.2	1.49	1.89	2.71	1.89	1.40	2.6
Norway	+ 28.0	Nov	+ 27.1	Sep	na	na	94.2	108.4	6.78	6.96	12.3	8.60	6.39	9.8
Portugal	− 13.1	Sep	− 7.8	Sep	na	na	93.2**	91.1	0.79	0.96	1.44	–	0.74	-2.9

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, November average. ‡OECD estimate.
**IMF, September average.

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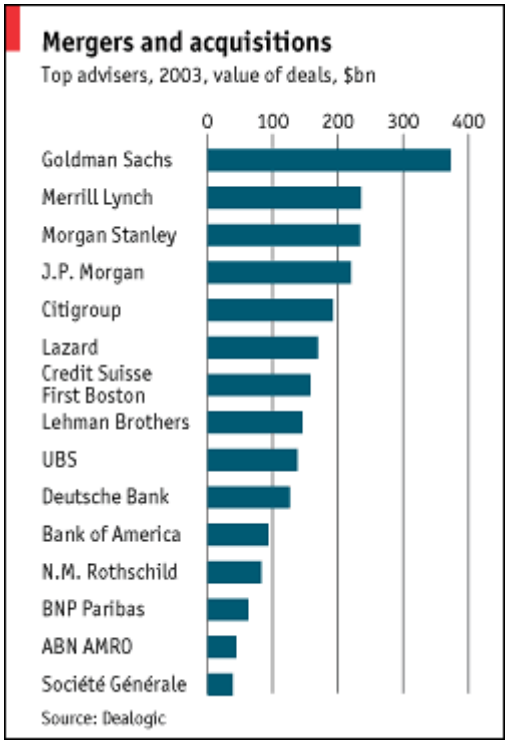
Mergers and acquisitions

Jan 8th 2004
From The Economist print edition



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Overview

Jan 8th 2004
From The Economist print edition

India's economy stormed ahead in the third quarter of last year, with GDP up by 8.4% over the same period in 2002. But growth in industrial production slowed in **Taiwan** and **Thailand** to 6.7% and 7.4% respectively in the year to November.

In **Turkey**, prices rose by 18.4% in the year to December, comfortably below the government's 20% target. Prices increased over the same period in **Russia** by 12%, down from 15.1% the year before. In **Chile**, prices rose by 1.1% in the 12 months to December, the lowest in 68 years. But inflation picked up in **Venezuela** to reach 27.1%.

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Stockmarkets

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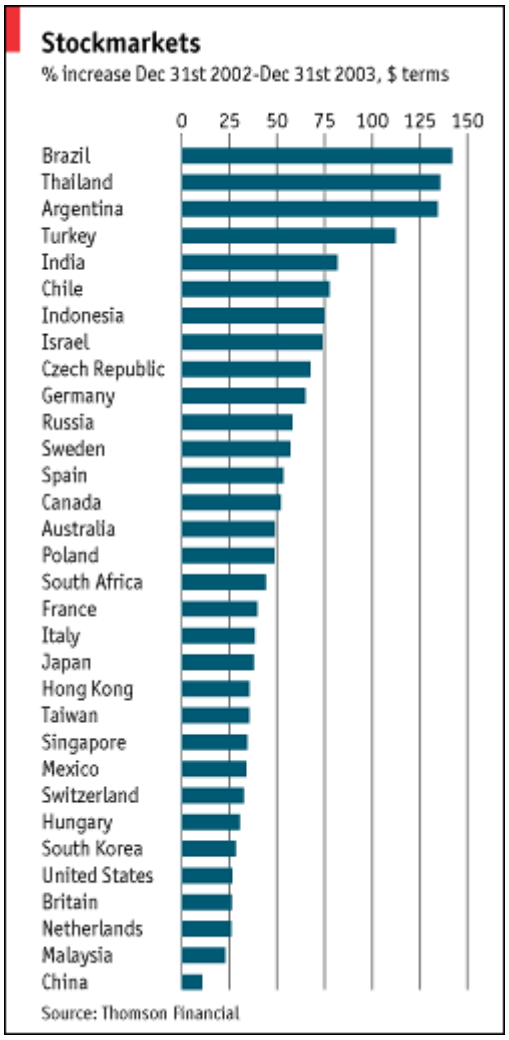
All the stockmarkets which *The Economist* tracks each week rose in 2003, following three years in which most markets fell. The emerging markets topped the league. Brazilian shares rose by an average of 142% in dollar terms. Share prices in Thailand, Argentina and Turkey also more than doubled. In many European markets, currency gains against the dollar were as big as the actual rise in share prices. Germany's DAX rose by 37% in euro terms, but by 65% in dollars. America's S&P 500 rose by only 26%. China was the worst performing market with an 11% gain.



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Economy

Jan 8th 2004
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.1	Q3	+17.9	Nov	+ 3.0	Nov	+22.9	Nov	+35.4	2002	406.0	Oct
Hong Kong	+ 4.0	Q3	– 9.2	Q3	– 2.3	Nov	– 8.0	Nov	+16.7	Q3	114.1	Nov
India	+ 8.4	Q3	+ 5.4	Oct	+ 3.1	Nov	–13.8	Nov	+ 2.3	Q3	92.2	Nov
Indonesia	+ 3.9	Q3	+ 4.7	Jul	+ 5.1	Dec	+26.8	Nov	+ 8.1	Q2	33.8	Nov
Malaysia	+ 3.5	Q3	+11.7	Nov	+ 1.1	Nov	+19.3	Nov	+11.9	Q3	44.0	Nov
Philippines	+ 4.4	Q3	– 3.9	Oct	+ 3.1	Dec	– 1.4	Oct	+ 3.4	Sep	13.3	Nov
Singapore	+ 1.7	Q3	+ 7.7	Nov	+ 0.6	Nov	+15.7	Nov	+25.6	Q3	93.9	Nov
South Korea	+ 2.3	Q3	– 3.9	Nov	+ 3.4	Dec	+14.4	Dec	+ 9.8	Nov	150.3	Nov
Taiwan	+ 4.2	Q3	+ 6.7	Nov	– 0.1	Dec	+17.0	Dec	+28.8	Q3	206.6	Dec
Thailand	+ 6.5	Q3	+ 7.4	Nov	+ 1.8	Dec	+ 4.5	Nov	+ 8.1	Nov	40.2	Nov
Argentina	+ 7.6	Q2	+13.0	Nov	+ 3.7	Dec	+16.6	Nov	+ 8.9	Q3	14.1	Dec
Brazil	– 1.5	Q3	+ 1.1	Oct	+11.0	Nov	+23.9	Nov	+ 3.7	Nov	54.4	Nov
Chile	+ 3.0	Q3	+ 1.5	Nov	+ 1.1	Dec	+ 2.9	Dec	– 0.3	Q3	15.8	Nov
Colombia	+ 4.0	Q3	+ 2.3	Oct	+ 6.5	Dec	– 0.2	Sep	– 1.7	Q2	10.5	Dec
Mexico	+ 0.4	Q3	– 0.8	Oct	+ 4.0	Nov	– 5.6	Nov	–10.5	Q3	57.3	Nov
Peru	+ 4.1	Oct	+ 0.7	Oct	+ 2.5	Dec	+ 0.5	Oct	– 1.2	Q3	9.6	Nov
Venezuela	– 7.1	Q3	– 4.8	Oct	+27.1	Dec	+14.0	Q3	+ 8.9	Q3	14.2	Sep
Egypt	+ 3.1	2003†	+ 4.2	2002†	+ 5.2	Oct	– 6.0	Jul	+ 3.3	Q3	13.3	Aug
Israel	+ 2.8	Q3	– 4.9	Oct	– 2.0	Nov	– 6.5	Nov	– 0.2	Q3	24.4	Nov
South Africa	+ 1.6	Q3	– 2.6	Oct	+ 0.4	Nov	+ 2.0	Nov	– 1.3	Q3	6.5	Nov
Turkey	+ 4.8	Q3	+12.3	Oct	+18.4	Dec	–20.9	Oct	– 5.2	Sep	31.3	Nov
Czech Republic	+ 3.4	Q3	+ 5.2	Oct	+ 1.0	Nov	– 2.4	Nov	– 7.8	Q3	26.0	Nov
Hungary	+ 2.9	Q3	+ 9.9	Oct	+ 5.6	Nov	– 4.3	Nov	– 5.5	Oct	12.6	Nov
Poland	+ 3.9	Q3	+ 9.1	Nov	+ 1.6	Nov	– 9.5	Nov	– 2.9	Nov	32.6	Dec
Russia	+ 5.7	Q3	+ 7.1	Nov	+12.0	Dec	+58.0	Oct	+39.1	Q4	64.4	Nov
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 4.6	Q3	+ 9.1	Oct	+ 1.1	Dec	– 1.9	Nov	– 1.5	Q3	1.1	Nov
Latvia	+ 7.3	Q3	+ 1.0	Nov	+ 3.6	Nov	– 1.9	Oct	– 0.9	Oct	1.4	Nov
Lithuania	+ 8.4	Q3	na		– 1.0	Nov	– 2.4	Oct	– 1.1	Q3	3.0	Nov
Slovakia	+ 4.2	Q3	+ 4.9	Oct	+ 9.8	Nov	– 0.6	Nov	– 0.8	Sep	10.9	Nov
Slovenia	+ 2.3	Q3	+ 2.4	Nov	+ 4.6	Dec	– 0.6	Sep	+ 0.1	Oct	8.0	Oct
Pakistan	+ 5.1	2003†	+ 7.5	Jul	+ 4.2	Nov	– 1.3	Dec	+ 3.6	Q3†	10.8	Nov
Saudi Arabia	+ 1.0	2002	na		– 1.2	Jul	+41.8	2002	+11.9	2002	24.5	Nov

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

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	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jan 7th		Dec 31st 2002	
	Jan 7th	year ago	Jan 7th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	15.1	na	1,664.5	+6.1	+ 17.3	+ 17.3
Hong Kong	7.76	7.80	14.1	0.11	13,157.7	+4.6	+ 41.2	+ 41.8
India	45.5	48.1	82.8	4.24	5,957.0	+2.0	+ 76.4	+ 85.9
Indonesia	8,363	8,890	15,226	8.59	709.4	+2.5	+ 66.9	+ 78.6
Malaysia	3.80	3.80	6.92	3.03	805.8	+1.5	+ 24.7	+ 24.7
Philippines	55.2	53.7	100.5	7.88	1,516.1	+5.1	+ 48.9	+ 44.0
Singapore	1.70	1.75	3.09	0.72	1,836.0	+4.0	+ 36.9	+ 40.0
South Korea	1,187	1,202	2,160	4.33	827.1	+2.0	+ 31.8	+ 31.7
Taiwan	33.8	34.8	61.5	1.15	6,141.3	+4.3	+ 37.9	+ 42.0
Thailand	39.0	43.0	71.0	1.34	751.0	– 2.7	+110.7	+132.8
Argentina	2.87	3.51	5.22	4.25	1,162.8	+8.5	+121.5	+159.9
Brazil	2.86	3.53	5.21	16.35	23,320.1	+4.9	+107.0	+155.9
Chile	567	696	1,032	2.28	7,211.0	– 1.7	+ 43.7	+ 82.5
Colombia	2,757	2,822	5,018	7.92	2,455.2	+5.2	+ 52.6	+ 58.7
Mexico	10.9	10.3	19.9	5.49	9,098.2	+3.4	+ 48.5	+ 42.4
Peru	3.46	3.50	6.30	2.49	2,493.8	+2.4	+ 79.2	+ 81.9
Venezuela	2,901§	1,427	5,282	20.04	23,642.8	+6.5	+195.0	+ 41.0
Egypt	6.17	4.62	11.22	6.89	12,229.3	+5.1	+127.7	+ 71.0
Israel	4.40	4.67	8.01	1.66	550.3	+3.0	+ 65.5	+ 78.6
South Africa	6.60	9.00	12.0	7.95	10,513.6	+1.2	+ 13.3	+ 47.4
Turkey	1,367,000	1,621,950	2,488,760	24.00	19,382.8	+4.1	+ 86.9	+127.0
Czech Republic	25.5	30.4	46.5	2.07	674.1	+2.3	+ 46.3	+ 72.4
Hungary	207	229	377	12.05	9,595.3	+2.3	+ 23.0	+ 33.7
Poland	3.68	3.89	6.70	5.21	21,972.6	+5.5	+ 52.9	+ 59.4
Russia	29.2	31.9	53.2	16.00	592.6‡	+4.5	+ 51.0	+ 65.0
EMF (MSCI)*	1.00	1.00	1.82	na	459.8	+3.9	+ 57.4	+ 57.4
EMBI+†	1.00	1.00	1.82	na	300.1	+1.8	+ 31.1	+ 31.1

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms. § Floating exchange rate

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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